

BEFORE THE
ILLINOIS COMMERCE COMMISSION

IN THE MATTER OF:)
)
NORTH SHORE GAS COMPANY,)
) No. 11-0280
Proposed general increase in) 11-0281
natural gas rates. (Tariffs) (Consolidated)
filed February 15, 2001,))
)
THE PEOPLES GAS LIGHT and COKE)
COMPANY,)
)
Proposed general increase in)
natural gas rates. (Tariffs)
filed February 15, 2011.))

Chicago, Illinois
August 31, 2011

Met pursuant to notice at 9:30 a.m.

BEFORE:

MR. TERRANCE HILLIARD and MR. DOUGLAS E. KIMBREL,
Administrative Law Judge.

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20

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Alisa Sawka, CSR, RPR

1	<u>I N D E X</u>				
2	<u>Witnesses:</u>	<u>Direct</u>	<u>Cross</u>	<u>Re-direct</u>	<u>Re-cross</u> <u>By Examiner</u>
3	MICHAEL P. GOODMAN				
4		360	363		
5	STEVEN M. FETTER				
6		374	378		
7	LISA J. GAST				
8		393	396		
9	SHEENA KNIGHT-GARLISCH				
10		404	407		
11	DAVID E. DISMUKES, Ph.D				
12		414	418		
13	PAUL R. MOUL				
14		428	432		
15			462		
16			469		
17			489		496
18	MICHAEL MCNALLY				
19		499	504		
20			518		
21		613		616	
22					

1	<u>E X H I B I T S</u>		
2	<u>Number</u>	<u>For Identification</u>	<u>In Evidence</u>
3	IIEC-CNEG		
4	#1.0&2.0		362
5	NS/PGL		
	#20,20.1,20.2,20.3		377
6	18.0,18.1N,18.1P18.2P		395
	35.0,35.1N,35.1P35.2P		395
7	35.3P35.4P		395
	#19.0 to 19.12,36.0		432
8	#1	538	
	#2	551	
9	#3&4	564	
	#1,2,3,5		621
10			
11	NS		
	#2.0 through 2.4		395
12	#3.0,3.13		432
13			
	PGL		
14	#2.0 through 2.4		395
	#3.0 to 3.13		432
15			
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1	<u>E X H I B I T S</u>		
2	<u>Number</u>	<u>For Identification</u>	<u>In Evidence</u>
3			
4	STAFF		
5	#1	396	402
	#2&3	399	402
6	#4.0,4.1,4.2N corrected		407
	4.2P corrected, 4.3n,		407
7	4.3p,13.0 through 13.5 and A		407
	#4		469
8	#5	474	479
	#6	483	486
9	#7	786	488
	#2.0&14.0		503
10			
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1 JUDGE HILLIARD: Could you all raise your hand
2 and be sworn.

3 (Witnesses sworn.)

4 JUDGE HILLIARD: On behalf of the Illinois
5 Commerce Commission, I call Docket 11, dash, 280 and
6 11, dash, 281, proposed general increase in natural
7 gas rates for North Shore Gas Company and Peoples Gas
8 Company.

9 Mr. Gorman, I think you're the first
10 one up today; is that right?

11 MR. ROBERTSON: I believe that's correct, your
12 Honor.

13 JUDGE HILLIARD: Okay. Could you introduce
14 Mr. Gorman.

15 MR. ROBERTSON: Yes.

16 Should I enter my appearance first?

17 JUDGE HILLIARD: Sure.

18 MR. ROBERTSON: I don't think I entered my
19 appearance yet.

20 Eric Robertson and Ryan Robertson of
21 Lueders, Robertson & Konzen, P.O. Box 735, 1939
22 Delmar Avenue, Granite City, Illinois, on behalf of

1 the Illinois Industrial Energy Consumers and
2 Constellation New Energy Gas Division, LLC.

3 Thank you, Judge.

4 We would call Mr. Michael Gorman.

5 MICHAEL P. GORMAN,
6 called as a witness herein, having been first duly
7 sworn, was examined and testified as follows:

8 DIRECT EXAMINATION

9 BY

10 MR. ROBERTSON:

11 Q Mr. Gorman, would you identify yourself for
12 the record, please.

13 A My name is Michael Gorman.

14 Q And on whose behalf are you appearing here
15 today?

16 A On behalf of the Illinois Industrial Energy
17 Consumers and Constellation New Energy.

18 Q And I show you now what has been previously
19 marked as and filed on e-Docket as IIEC-CNEG Joint
20 Exhibit 1.0 entitled The Direct Testimony of Michael
21 P. Gorman and ask you whether or not that document
22 was prepared under your supervision and at your

1 direction?

2 A It was.

3 Q And if I were to ask you the questions that
4 are contained therein today, would your answers be
5 the same as are contained therein?

6 A Yes.

7 Q And is the document true and correct to the
8 best of your information and belief?

9 A It is.

10 Q I show you also what has been previously
11 marked as IIEC-CNEG Joint Exhibit 2.0 entitled
12 Rebuttal Testimony of Michael P. Gorman.

13 Are you familiar with that document?

14 A Yes.

15 Q Was it prepared under your supervision and
16 at your direction?

17 A Yes.

18 Q And if I were to ask you the questions
19 contained therein, would your answers be the same as
20 are contained therein?

21 A Yes.

22 Q And is the document true and correct to the

1 best of your information and belief?

2 A Yes.

3 MR. ROBERTSON: With that, your Honor, I would
4 move the admission of IIEC-CNEG Joint Exhibit 1.0,
5 the direct testimony of Michael P. Gorman, and
6 IIEC-CNEG Joint Exhibit 2.0, the rebuttal testimony
7 of Michael P. Gorman, subject to cross-examination.

8 JUDGE HILLIARD: Objections?

9 Hearing no objections, IIEC-CNG (sic)
10 Exhibit 1 -- Joint Exhibit 1.0 and Joint Exhibit 2.0
11 will be admitted into the record.

12 (Whereupon, IIEC-CNEG
13 Joint Exhibit Nos. 1.0
14 and 2.0 were admitted
15 into evidence.)

16 JUDGE HILLIARD: Tender the witness for
17 cross-examination?

18 MR. ROBERTSON: Yes, sir.

19 JUDGE HILLIARD: Please proceed.

20

21

22

1 CROSS-EXAMINATION

2 BY

3 MS. KLYASHEFF:

4 Q Good morning, Mr. Gorman.

5 A Good morning.

6 Q My name is Mary Klyasheff and I represent
7 the Utilities in this proceeding.

8 I have some questions that are
9 directed to your direct testimony. In particular, if
10 you could reference Page 8, testimony at
11 approximately Line 144.

12 A I'm there.

13 Q You refer to your customer injections and
14 withdrawals as effectively paper entries.

15 At this part of your testimony, are
16 you referring to the proposed Rider SBS service?

17 A Yes.

18 Q Are you familiar with the Utilities current
19 Rider SST service?

20 A Yes.

21 Q Are storage injections and withdrawals
22 under that service also in the nature of paper

1 entries?

2 A For the purpose of establishing cash
3 transactions, yes.

4 Q Under that current rider, does a storage
5 injection occur without a nomination for an
6 injection?

7 A It's -- well, typically the nomination, if
8 it exceeds actual usage, it would be directed to be
9 injected in storage.

10 Q Would the nomination be for deliveries to
11 the system or for deliveries into storage?

12 A Deliveries to the system.

13 Q So is the paper entry for a storage
14 injection when usage is less than the amount
15 delivered to the system?

16 A Correct.

17 Q So the paper entry, it's a paper entry, but
18 it's based on actual physical gas delivers relative
19 to actual physical usage?

20 A That's correct. The point being is one
21 individual customer doesn't determine whether or not
22 an injection in the storage needs to take place on a

1 system-wide basis, but it is important for that
2 individual customer in determining nominations that
3 may exceed their expected usage for that day.

4 Q And the proposed rider would still have
5 that feature of it is paper entries based on actual
6 usage relative to physical deliveries?

7 A Yes.

8 Q Is that also true of how storage
9 withdrawals work under the current system, other than
10 in that case, usage and deliveries, the relationship
11 is different?

12 A Yes.

13 Q In that case, we're talking about if usage
14 is more than deliveries, there may be a paper entry
15 for a withdrawal?

16 A Correct.

17 Q Would an alternative to this sort of paper
18 entry system be to actually have a customer nominate
19 an injection or nominate a withdrawal?

20 A It would be more of an administrative
21 burden on the customer, but that is a way to properly
22 track what is delivered to the system and what is

1 used by the customer and what is set aside for future
2 use or conversely what has been withdrawn from that
3 which has already been set aside and that which is
4 delivered to the system to meet the daily needs of
5 the customer.

6 Q If there were a system with a nominated
7 injection in the storage, then would it be your
8 expectation that nomination would determine what goes
9 into storage irrespective of the customer usage?

10 A I'm sorry. Can you repeat that again,
11 please.

12 Q If the service were structured such that
13 the customer or its supplier made a nomination for
14 storage injections, would the quantity accounted for
15 as an injection be that quantity irrespective of
16 usage?

17 A Well, I'd have to look at those
18 circumstances -- that's a new proposal -- but,
19 generally, that is something that could be used to
20 administer deliveries relative to use and then that
21 available for other injection or withdraw from
22 storage.

1 Q Would it be accurate to characterize the
2 paper entry-type process as a no-notice storage
3 service?

4 A Well, I think the concept of using
5 storage -- the structure under which the pricing
6 mechanics and the diversity of the entire load allows
7 for these paper transactions to occur on the
8 Utility's systems.

9 If you want to put a different label
10 to it, I'd have to make an evaluation of what
11 connotations you're trying to raise with that
12 description of those activities.

13 Q Are you familiar with the use of the term
14 "no-notice storage" as interstate pipelines use it?

15 A Generally, yes.

16 Q Do you consider that system to be something
17 that involves paper-type transactions?

18 A Well, it can be because the concept of line
19 packing the load diversity can impact what is
20 delivered to the pipeline and what is taken out of
21 the pipeline and that which is recording as delivered
22 to storage or withdrawn from storage.

1 So it is a paper trial that kind of
2 comes in behind all the injections into the pipeline
3 and withdrawals from the pipeline. So you don't
4 follow a molecule gas and put your name on it and
5 track it to either storage or consumption or delivery
6 to the pipeline. It's a way of balancing the system.

7 Q If I could reference Page 9 of your direct
8 testimony, Line 154.

9 A Okay.

10 Q The very first sentence there under
11 "present rates," there is no daily balancing?

12 A Correct.

13 Q Is the context of that statement only the
14 cash-out activity?

15 A It is.

16 Q Under current Rider SST, do you know if
17 customers are required to have daily measurement
18 devices?

19 A I believe they are, yes.

20 Q Under that rider, is there a daily
21 nomination limit?

22 A Yes.

1 Q And under that rider, are there some daily
2 injection and withdrawal limits applicable on
3 critical days?

4 A Yes.

5 Q And also on Page 9, but towards the bottom
6 of the page, beginning on Line 169 and carrying over
7 the first couple lines of Page 10, you testify about
8 customers using storage as they chose, but also state
9 that some guidelines may be necessary to ensure that
10 the facilities can physically operate effectively?

11 A Yes.

12 Q Would Peoples Gas' in the field and
13 physical limitations associated with that field be an
14 example?

15 A Yes.

16 Q Are limitations to allow a storage field to
17 physically operate effectively the only type of
18 limitations that you would consider appropriate?

19 A Well, there can be constrained periods that
20 can also be a factor. And there could be problems
21 with facilities which can impact the daily nomination
22 and deliverability of the system.

1 Q Can you give an example of what you have in
2 mind with the idea of a constrained period?

3 A A constrained period when the delivered --
4 the supply delivered to the system is not capable of
5 meeting demands on the system. On such a condition,
6 there may be limits on how much gas the system can
7 deliver to any of these customers.

8 Q Do you agree that some of the services that
9 the Utilities use to support their transportation
10 program services are purchased from interstate
11 pipelines?

12 A Yes.

13 Q And do you agree that those pipelines have
14 tariffs that govern the use of those services?

15 A Yes.

16 Q Should the limits imposed by pipelines on
17 these services that Peoples Gas and North Shore buy
18 affect the service they offer to transportation
19 customers?

20 A Well, that could be a physical limitation
21 on use of those storage assets. So it's part of the
22 consideration.

1 Q Does it matter if those tariff limits are
2 unrelated to the physical operations of the pipeline
3 facilities?

4 A Well, that's a physical limitation on how
5 the Utilities can use those storage assets. So it's
6 a contractual limitation on how they can use them.

7 Q If I may refer to Page 11 of your direct
8 testimony, beginning on Line 216.

9 A I'm there.

10 Q That sentence after the word "no" about
11 managing the system storage in a satisfactory manner,
12 to whom are you referring when you say it's been
13 satisfactory?

14 A Well, it's certainly been satisfactory to
15 the transportation customers. And to the extent
16 there's been any failure on the Company's ability to
17 operate their system with the current storage
18 restrictions that they -- I'm not aware of them.

19 Q Also on Page -- I'm sorry. This is on
20 Page 12, Line 235 where you discuss the benefits --
21 potential benefits of storage and you identify
22 potential benefit as a temporary parking space for

1 imbalances?

2 A Yes.

3 Q Do you agree that under the Company's

4 proposal, if a customer delivers more gas than it

5 uses on a day, it will be able to put that into

6 storage?

7 A Well, there's restrictions on how much they

8 can put in storage without paying the penalty; but

9 that is my understanding, yes.

10 Q It's your understanding that the customers'

11 deliveries do not need to exactly match their

12 consumption under the Company's proposal; is that

13 correct?

14 A Within the tolerance limits before

15 penalties kick in, that is true.

16 MS. KLYASHEFF: Thank you. I have no other

17 questions.

18 JUDGE HILLIARD: Any redirect?

19 MR. ROBERTSON: No, sir.

20 JUDGE HILLIARD: Thank you, Mr. Gorman.

21 MR. JOLLY: Does the witness need to be sitting

22 here?

1 JUDGE HILLIARD: Pardon?

2 MR. JOLLY: Does the witness need to be sitting
3 here?

4 MS. LUCKEY: Your Honors, Staff in Springfield
5 could not see the witness speaking.

6 JUDGE HILLIARD: I cannot hear you.

7 MS. LUCKEY: Staff in Springfield could not see
8 the witness speaking so we need to switch the camera
9 of the witness.

10 JUDGE KIMBREL: Where's the witness sitting?

11 MR. JACKSON: He's right here. Where would you
12 like him?

13 JUDGE KIMBREL: Right there.

14 JUDGE HILLIARD: Mr. Fetter, you've previously
15 been sworn; is that correct?

16 STEVEN FETTER: I have been sworn, yes, sir.

17 JUDGE HILLIARD: Okay. Could you introduce the
18 witness to us.

19 MR. JACKSON: Yes. Thank you.

20 My name is Brad Jackson, Foley &
21 Lardner, on behalf of the Utilities.

22 JUDGE HILLIARD: Is your microphone on?

1 MR. JACKSON: Good question.

2 Is that better?

3 JUDGE HILLIARD: Yes.

4 MR. JACKSON: Okay.

5 STEVEN M. FETTER,

6 called as a witness herein, having been previously

7 duly sworn, was examined and testified as follows:

8 DIRECT EXAMINATION

9 BY

10 MR. JACKSON:

11 Q State your name for the record, please.

12 A Steven M. Fetter.

13 Q And what is your business address?

14 A Post Office Box 280 Nordland,

15 N-o-r-d-l-a-n-d, Washington 98358.

16 Q Mr. Fetter, in connection with these

17 consolidated dockets, did you prepare a piece of

18 prefiled rebuttal testimony marked NS/PGL Exhibit 20?

19 A Yes.

20 Q And in connection with that testimony, did

21 you also prepare the exhibits marked 20.1, 0.2 and

22 0.3?

1 A Yes, I did.

2 Q Did you also prepare for this proceeding
3 prefiled written surrebuttal testimony marked NS/PGL
4 Exhibit 37?

5 A Yes, I did.

6 Q Do you have any corrections to any --
7 either piece of testimony or any of the exhibits?

8 A I just note that in the rebuttal testimony,
9 in Footnote No. 5, I cite two S&P research reports,
10 one on North Shore Gas Company and the other on
11 Peoples Gas Light and Coke Company, both dated
12 February 4, 2011.

13 I just note for the record that S&P
14 published a new report on Peoples Gas Light and Coke
15 on Friday, August 26th, 2011.

16 MR. JOLLY: Are you planning to move this into
17 the record?

18 MR. JACKSON: (Nonverbal response.)

19 MR. JOLLY: Okay.

20 BY MR. JACKSON:

21 Q Mr. Fetter, do you have any commentary on
22 the August 26th Standard & Poor's report?

1 MR. JOLLY: I object to this. This is
2 additional testimony that was -- we've not had an
3 opportunity to review or conduct discovery on or
4 respond to in any way. And to bring this in at the
5 last minute seems prejudicial and unfair.

6 JUDGE HILLIARD: What's your response?

7 MR. JACKSON: The report was just issued on
8 Friday, so we could hardly have introduced it sooner.
9 And it's an updated version of other reports that
10 other witnesses and Mr. Fetter have relied on in
11 their own testimony. So it's the most current and
12 up-to-date information from Standard & Poor's that's
13 available.

14 MR. JOLLY: There will always be additional
15 information available. I'm certain into the briefing
16 stage there will be additional reports. And is it
17 Peoples Gas' and North Shore's intention to then try
18 to move additional evidence into the record?

19 I mean, at some point it seems that
20 you have to stop taking in evidence, especially when
21 parties don't have an opportunity to respond to it.

22 JUDGE HILLIARD: I think there's an element of

1 unfairness involved in producing any document for
2 whatever reason at this late date. And I'd ask you
3 to confine your questions and testimony to the
4 documents that have been previously available to all
5 the parties.

6 MR. JACKSON: Your Honor, I'd move the
7 introduction of NS/PGL Exhibits 20, 20.1, 20.2, 20.3
8 and 37.

9 JUDGE HILLIARD: 20.3 and 37?

10 MR. JACKSON: 20, 20.1 --

11 JUDGE HILLIARD: 20, 20.1, 20.2, 20.3 and 37?

12 MR. JACKSON: Correct.

13 JUDGE HILLIARD: Objections?

14 MR. JOLLY: No objection.

15 JUDGE HILLIARD: Hearing no objections, North
16 Shore/Peoples Gas Exhibits 20, 20.1, 20.2, 20.3 and
17 37 will be admitted in the record.

18 (Whereupon, NS/PGL
19 Exhibit Nos. 20, 20.1,
20 20.2, 20.3 and 37 were
21 admitted into
22 evidence.)

1 MR. JACKSON: And the witness is available for
2 cross.

3 JUDGE HILLIARD: Proceed, Counsel.

4 MR. JOLLY: Thank you.

5 For the record, my name is
6 Ronald D. Jolly. I'm an attorney for the City of
7 Chicago. My business address is 30 North LaSalle,
8 Suite 1400, Chicago, Illinois 60602.

9 Also appearing on behalf of the City
10 today will be Conrad R. Reddick. His address is 1015
11 Crest Street, Wheaton, Illinois 60189.

12 CROSS-EXAMINATION

13 BY

14 MR. JOLLY:

15 Q Good morning, Mr. Fetter.

16 A Good morning, Mr. Jolly.

17 Q How are you?

18 A I'm fine. Thank you.

19 Q Could you turn to Page 13, Lines 275 to 276
20 of your rebuttal testimony, please.

21 A Yes, I'm there.

22 Q Okay. And there you refer to that you were

1 aware that the -- that prior Commission decisions
2 have indicated concern about relying upon data from
3 decisions in other jurisdictions.

4 Do you see that?

5 A Yes, I do.

6 Q What -- what concerns -- to what concerns
7 are you referring to there?

8 A I think the Commission had provided
9 commentary in an earlier Commonwealth Edison decision
10 about information -- ROE information from other
11 jurisdictions.

12 Q Okay.

13 MR. JOLLY: May I approach the witness?

14 JUDGE HILLIARD: Do you have a document?

15 MR. JOLLY: Yeah.

16 JUDGE HILLIARD: Sure.

17 MR. JACKSON: Is this already in the record?

18 MR. JOLLY: It's a Commission order.

19 JUDGE HILLIARD: Are you going to mark these or
20 not?

21 MR. JOLLY: No, I don't think so. They're
22 Commission orders so they can be cited to. So I

1 don't think it's necessary to mark them.

2 I've handed the witness excerpts from
3 two Commission orders, one is Illinois Commerce
4 Commission Docket 05-0597; the second -- which that
5 case was a Commonwealth Edison rate case -- and then
6 the second is an excerpt from Dockets 07, dash, 0241,
7 07, dash, 0242 consolidated, which in that case -- or
8 those cases involved rate cases filed by North Shore
9 Gas Company and the Peoples Gas Light and Coke
10 Company.

11 BY MR. JOLLY:

12 Q Could you turn to the excerpt from the
13 Commonwealth Edison order, please.

14 A I have it in my hand.

15 Q And at the very first paragraph under
16 "Commission analysis and conclusion" on Page 153, is
17 this what you were talking about when you said this
18 is a concern that was expressed by the Commission?

19 MR. JACKSON: I object, your Honor. These are
20 excerpts from Commission decisions. They can be
21 researched, cited in the briefs. They speak for
22 themselves.

1 JUDGE HILLIARD: I think he's asked him what --
2 if this is what he's referring to. It seems to me
3 that's a proper question.

4 MR. JACKSON: Okay.

5 So the question is whether these are
6 the specific orders he was referring to in his
7 testimony?

8 MR. JOLLY: He referred to a Commonwealth
9 Edison rate case order. And I'm asking him if this
10 is the rate case order to which he was referring.

11 THE WITNESS: I believe this would be one of
12 the paragraphs that I would have had in mind.

13 BY MR. JOLLY:

14 Q Okay. And going to the second order -- and
15 at Page 89 -- this is the 07-0241, 07-0242 -- towards
16 the bottom of the page there's a heading that states
17 "ROE comparisons."

18 Is that paragraph -- the first
19 paragraph under that heading, is that another place
20 where you believe that the Commission has expressed
21 concern about relying on return on equity
22 determinations by other jurisdictions?

1 A If I could check my surrebuttal before I
2 can answer if that's okay?

3 Q Sure.

4 A And the question again, sir?

5 Q Is this another order to which you were
6 referring to earlier when you said in your rebuttal
7 testimony that the Commission has expressed concerns
8 about relying on return on equity determinations from
9 other Commissions?

10 A Putting myself back in my frame of mind
11 when I wrote those sentences, I believe I was
12 primarily focused on the Commonwealth Edison language
13 because, as I note in my surrebuttal, there's later
14 language with regard to these two Utilities in this
15 case that I believe opens the door a little bit for
16 consideration of such data.

17 And so my sentence I wrote that you
18 initiated your cross with referred, I think, in my
19 mind, pretty much to the Commonwealth Edison
20 language.

21 Q Okay. Well, in your testimony, you attach
22 Exhibits 20.2 and 20.3, which are compendiums -- or

1 compendia of return on equity decisions from other
2 jurisdictions; is that correct?

3 A Yes.

4 Q And Exhibit 20.2 covers five years of
5 return on equity decisions?

6 A Yeah, one is five and one is 20.

7 Q Right. The 20.3 is --

8 A Yes.

9 Q -- 20 years?

10 Okay. And in your rebuttal testimony
11 you have a heading there that you say -- before going
12 into your description of those two exhibits, you are
13 saying -- the heading states, Putting ROE
14 recommendations in context.

15 And going back to the order in the
16 07-0241 consolidated case, isn't it true that the
17 Commission say -- says in the second sentence that,
18 They, being the Utilities, assert that previously
19 approved ROEs serve as guideposts for our analysis in
20 these cases and insists that they are not -- their
21 returns should be based on the authorized returns of
22 other Utilities.

1 Do you see that sentence?

2 MR. JACKSON: Your Honor, I object. This -- I

3 believe the witness has testified that this was not

4 one of the orders he relied on for the specific

5 statement in his testimony.

6 JUDGE HILLIARD: I think it's a preliminary

7 question. Why don't we see where he's going.

8 THE WITNESS: I'm sorry, Mr. Jolly, could you

9 ask the question again.

10 BY MR. JOLLY:

11 Q Sure.

12 In the second sentence under the

13 heading "ROE comparisons" --

14 A Yes.

15 Q -- that begins "they assert."

16 Do you see that?

17 A Yes.

18 Should I read it and then you'll

19 ask --

20 Q Sure.

21 A -- a question?

22 Q Yes.

1 A I've read it.

2 Q Okay. In your opinion, is providing
3 context for the Commission in this case different
4 than providing guideposts?

5 A Yes.

6 Q Okay. Now, going back to -- turning to
7 the -- Page 90 of the consolidated case, there's a
8 paragraph that's the second full paragraph on the
9 page that begins "less dramatically."

10 Is it true in that paragraph that the
11 Commission identifies certain characteristics of
12 other ROE determinations that it has no information
13 on?

14 A Should I read the paragraph?

15 Q Yeah, could you, please.

16 A It's the one that starts "less
17 dramatically"?

18 Q Yes.

19 A I'll read that.

20 Q Okay.

21 A I've read it.

22 Q Okay. And in the context of that

1 paragraph, the Commission identifies certain
2 characteristics of the other decisions that it does
3 not have information about to -- that it could use in
4 making the determination -- ROE determination in the
5 consolidated cases; is that accurate?

6 A That's -- the paragraph kind of says that.

7 Q Okay. Kind of more or less.

8 So in your Exhibits 20.2 and 20.3,
9 you've made no analysis of, for example, the
10 financial strengths, capital structure, credit status
11 or any of these other factors that -- of the
12 Utilities that were involved in the many decisions
13 that were included in 20.2 and 20.3; is that correct?

14 A Well, in those -- in those exhibits, I'm
15 taking the quantum of all decisions made in the past
16 20 years and the past five years, which would cover
17 characteristics from A to Z. And while each one
18 would have to be reviewed on its specific data, the
19 point I'm attempting to make is that this vast
20 universe of decisions compared to the recommendations
21 from your witness and another witness, is that they
22 view that their particular characteristics set

1 themselves apart from virtually 20 years of
2 decisions.

3 And as a former regulator -- you know,
4 the ROE process and expert witnesses, it's very, very
5 complex; but as a former regulator, if someone came
6 in and said to me, We're proposing a result that
7 differs on the -- either on the downside or the
8 upside from virtually every decision that came
9 before, I would be very concerned about that and I
10 would dig very deeply into the testimony of the ROE
11 witnesses, which is basically what I recommended
12 here.

13 I'm not telling the honorable ALJs or
14 the Commission to do averaging or pick a jurisdiction
15 they like or pick a time period they like. I'm
16 saying, when recommendations come in that are out of
17 sorts with 20 years of past decision making in this
18 jurisdiction and other jurisdictions, it rings a bell
19 in my head that something's wrong with those
20 recommendations.

21 Q Okay. Well, you -- again, just to answer
22 my question, you provided no analysis of the specific

1 characteristics in each of those cases?

2 A I did not.

3 Q Okay.

4 A I did not look at any one case.

5 Q Okay.

6 A I looked at them as an overall universe.

7 Q And in terms of providing context, what --

8 do you agree that Mr. Moul's original recommendation

9 was 11.25 percent?

10 A That's my understanding. And he lowered it

11 on -- at a later point in the case.

12 Q Okay. And I made an effort to separate the

13 gas utilities out from the electric utilities in

14 Exhibit 20.2. And my -- my reading of those

15 decisions, I found that there were only two cases

16 whereby there were returns on equities -- returns on

17 equity approved below Mr. Moul's 11.25 percent?

18 A During which time period?

19 Q In Exhibit 20.2, it's on the second page.

20 And I have a blown-up version of it. I know it's

21 hard to read. So...

22 A Is that the five-year?

1 Q Yes, the five-year.

2 MR. JOLLY: Would you be interested in a larger

3 copy?

4 JUDGE HILLIARD: Sure.

5 BY MR. JOLLY:

6 Q And the two returns I found are California

7 utilities and they appear towards the top of Page 2.

8 And I was looking only at natural gas utilities.

9 A Was there a question?

10 Q Are you aware of any other returns from

11 natural gas utilities in Exhibit 20.2 other than

12 these two that are above Mr. Moul's original

13 recommendation of 11.25 percent?

14 A I'd have to review it; but let me know that

15 if we take away the electric from the compendium,

16 then the loan one that matched Mr. McNally's goes

17 away, then Mr. McNally and Mr. Thomas are below every

18 decision, I believe, during the last 20 years.

19 Q Okay.

20 A As far as whether there are more than the

21 two above the 11.25, I'd have to study this; but the

22 data will speak for itself.

1 Q Okay.

2 JUDGE HILLIARD: Mr. Fetter, we've got a long
3 day of testimony scheduled here and I would -- I
4 appreciate your expertise and your knowledge, but
5 it's going to save time if you answer his questions
6 instead of providing extended explanations of the
7 overall picture of the industry.

8 THE WITNESS: Okay. Sorry, your Honor. I was
9 just trying to make apples and apples.

10 MR. JOLLY: Okay. Well --

11 MR. JACKSON: Your Honor, I was going to object
12 that the document speaks for itself, but...

13 MR. JOLLY: I assume I can ask questions about
14 a document attached to his testimony.

15 MR. JACKSON: Well, you're asking him to
16 describe a document that's right in front of us.

17 MR. JOLLY: No, I'm asking him if there are
18 additional returns above what --

19 MR. JACKSON: If it says what it says, you can
20 say that on brief.

21 JUDGE HILLIARD: We're not going to have a
22 colloquy between counsel.

1 If you have an objection, you make it
2 to the bench.

3 MR. JACKSON: I object that the document speaks
4 for itself.

5 JUDGE HILLIARD: The objection is overruled.

6 BY MR. JOLLY:

7 Q Including the electric utilities, let's
8 assume that maybe there are five of the 347 returns
9 on equity decisions that you report there that are
10 above Mr. Moul's original recommended 11.25 percent,
11 would that -- would that give you the same level of
12 concern you have in terms of the context that you
13 said you were providing with respect to the returns
14 on equity recommended by Mr. -- Staff Witness
15 Mr. McNally and GCI Witness Mr. Thomas?

16 A As I said, the information either on the
17 downside or the upside, depending on how out of sorts
18 it is, would lead me to encourage the ALJs and the
19 Commission to look deeply into both the Intervenor
20 Staff witnesses on ROE and also Mr. Moul on ROE.

21 MR. JOLLY: I have no further questions.

22 JUDGE HILLIARD: Thank you.

1 Is there another questioner?

2 MR. JOLLY: I think CUB is -- does not have

3 cross.

4 MS. MUNSCH: We waive cross, your Honor.

5 JUDGE HILLIARD: You waive cross.

6 MS. MUNSCH: (Nonverbal response.)

7 JUDGE HILLIARD: Okay. Redirect?

8 MR. JACKSON: No.

9 JUDGE HILLIARD: Then you're through,

10 Mr. Fetter.

11 THE WITNESS: Okay. Thank you, your Honors.

12 MR. LANNON: Your Honor --

13 JUDGE HILLIARD: Yes.

14 MR. LANNON: -- may I have one minute, please?

15 JUDGE HILLIARD: Sure.

16 (Off the record.)

17 JUDGE HILLIARD: Whenever you're ready.

18

19

20

21

22

1 LISA J. GAST,
2 called as a witness herein, having been previously
3 duly sworn, was examined and testified as follows:
4 DIRECT EXAMINATION
5 BY
6 MR. JACKSON:
7 Q Would you state your name for the record,
8 please.
9 A Lisa J. Gast.
10 Q And what is your business address?
11 A Integrlys Energy Group, 700 North Adams
12 Street, P.O. Box 19001, Green Bay, Wisconsin 54307.
13 Q And, Ms. Gast, have you prepared direct,
14 rebuttal and surrebuttal testimony in this matter?
15 A Yes, I have.
16 Q And your direct testimony has been marked
17 NS Exhibit 2.0 and PGL Exhibit 2.0; is that correct?
18 A Yes, it is.
19 Q In connection with that direct testimony,
20 did you also prepare or have prepared at your
21 direction the exhibits marked 2.1 NS, Exhibit 2.1,
22 2.2, 2.3 and 2.4 and PGL Exhibit 2.1, 2.2, 2.3 and

1 2.4?

2 A Yes.

3 Q Did you also prepare rebuttal testimony

4 that's been marked NS/PGL Exhibit 18.0?

5 A Yes.

6 Q And in connection with that piece of

7 testimony, did you have prepare- -- did you prepare

8 or have prepared at your direction the exhibits

9 marked NS/PGL Exhibit 18.1 N, 18.1 P and 18.2 P?

10 A Yes, I did.

11 Q And did you also prepare the surrebuttal

12 testimony marked NS/PGL Exhibit 35.0?

13 A Yes.

14 Q And in connection with that piece of

15 testimony, did you also prepare or have prepared at

16 your direction the exhibits marked NS/PGL

17 Exhibit 35.1 N, 35.1 P, 35.2 P, 35.3 P and 35.4 P?

18 A Yes.

19 Q Do you have any corrections to any of the

20 pieces of testimony or any of the exhibits?

21 A No, I do not.

22 Q If I were to ask you the questions

1 contained in your pieces of prefiled testimony today,
2 would your answers be the same?

3 A Yes, they would.

4 MR. JACKSON: Your Honor, I move the identified
5 exhibits.

6 JUDGE HILLIARD: Objections?

7 MR. LANNON: No objection, your Honor.

8 JUDGE HILLIARD: Hearing no objection, NS/PGL
9 Exhibit 2.0 with attachments, 18.0 with attachments
10 and 35.0 with attachments are admitted in the record.

11 (Whereupon, Exhibits NS
12 2.0 through 2.4, PGL 2.0
13 through 2.4, NS/PGL 18.0,
14 18.1 N, 18.1 P, 18.2 P,
15 NS/PGL 35.0, 35.1 N,
16 35.1 P, 35.2 P, 35.3 P and
17 35.4 P were admitted into
18 evidence.)

19 MR. JACKSON: Thank you, your Honor, the
20 witness is available for cross.

21 MR. LANNON: Your Honor, may I approach?

22 JUDGE HILLIARD: Please.

1 MR. LANNON: I'd like to mark this as Staff
2 Cross Exhibit 1. It's a portion of the Company's '10
3 annual report -- actually the Integrys annual report
4 examination.

5 (Whereupon, Staff Cross
6 Exhibit No. 1 was marked
7 for identification, as of
8 this date.)

9 CROSS-EXAMINATION

10 BY

11 MR. LANNON:

12 Q Hello, Ms. Gast.

13 A Hello.

14 Q Mike Lannon. I represent Staff. And I
15 have a few questions -- well, if you could turn to
16 your surrebuttal, Page 11, and starting on Line 221
17 on my version at least --

18 A I found it.

19 Q -- you state that, Stock options are
20 granted at an exercise price equal to the grant
21 date's closing market price.

22 Did I read that right?

1 A Yes, you did.

2 Q Okay. Is the grant date the same as the
3 date the stock option is exercised?

4 A No.

5 Q Would you agree that Integrys pays out
6 shares of its common stock for performance stock
7 rights?

8 A Yes.

9 Q And can you tell me what the dollar amount
10 that Integrys receives for each performance stock
11 right granted relative to current market value.

12 A My understanding is that they don't -- they
13 wouldn't receive cash. They're receiving, like,
14 employee services. It's -- rather than compensation
15 dollars, they're receiving stock.

16 Q So that value --

17 Which I believe you're saying is -- is
18 the value of labor, so to speak?

19 A Right.

20 Q -- is that calibrated anyway, you know, in
21 granting these compensation stocks?

22 A It would be the market price.

1 Q I'm sorry. I couldn't hear you.

2 A The market price.

3 Q It would be the same as the market price?

4 A Yes.

5 Q Thank you.

6 Would you agree that Integrys pays out

7 shares of its common stock for restricted shares and

8 restricted share units?

9 A Yes.

10 Q And, again, this is similar to the other

11 question I had about the value.

12 Can you tell me what the dollar amount

13 that Integrys receives for each restricted share --

14 or restricted share unit granted is relative to the

15 current market value?

16 A It's similar to the performance shares,

17 where they're receiving services rather than cash.

18 Q I'm sorry. I've got a sinus and ear

19 infection and I'm having a hard time hearing.

20 A Okay. I'll try and speak louder.

21 Q Thank you.

22 A Similar to the performance shares, they're

1 receiving services rather than cash; but they're also
2 valued at market price.

3 MR. LANNON: Your Honor, may I approach the
4 witness?

5 JUDGE HILLIARD: Yes.

6 (Whereupon, Staff Cross
7 Exhibit No. 2 was marked
8 for identification, as of
9 this date.)

10 MR. LANNON: And I have one more, your Honor.

11 JUDGE HILLIARD: Okay. Are you going to be
12 marking these? Cross 2?

13 MR. LANNON: Cross 2, and this will be Cross 3.

14 (Whereupon, Staff Cross
15 Exhibit No. 3 was marked
16 for identification, as of
17 this date.)

18 BY MR. LANNON:

19 Q Now, I've handed you two documents,
20 correct?

21 A Correct.

22 Q These are the Company's and, I assume, your

1 responses to Staff DRs?

2 A Yes, they are.

3 Q And that would be responses to Staff DRSK

4 8.01 --

5 A Yes.

6 Q -- correct?

7 MR. LANNON: And, your Honor, mark that as

8 Staff Cross Exhibit 2.

9 BY MR. LANNON:

10 Q And the second document was the

11 Company's and, I assume, yours -- your response to SK

12 dot 02?

13 JUDGE HILLIARD: 8.02.

14 MR. LANNON: Excuse me, SK 8.02. Correct, your

15 Honor.

16 And that we'll mark as Staff Cross

17 Exhibit 3.

18 BY MR. LANNON:

19 Q Now, we'll just put Staff Cross Exhibit 2

20 aside. I just wanted that in the record for

21 Commission.

22 And in your response to Staff Data

1 Request SK 8.02, you state that funds derived from
2 sales of natural gas service is a source of capital,
3 correct?

4 A Correct.

5 Q I find that kind of confusing. And maybe
6 if we could just walk through some basic principles,
7 it might help me understand it.

8 Would you agree that revenues,
9 including revenues from sales, minus expenses, is net
10 income?

11 A Yes.

12 Q Would you agree that net income after the
13 payment of dividends is retained earnings?

14 A Yes.

15 Q And would you agree that retained earnings
16 are part of equity?

17 A Yes.

18 Q And would you agree with me that the way a
19 company can raise cash is through issuing common
20 stock, issuing debt, long-term or short, or through
21 operations?

22 A Yes.

1 MR. LANNON: No further questions.

2 Oh, your Honor, I'd move for --

3 JUDGE HILLIARD: Do you want to move these into

4 the record?

5 MR. LANNON: Yes, I move for admittance of

6 Staff Cross Exhibits 1 through 3.

7 MR. JACKSON: No objection, your Honor.

8 JUDGE HILLIARD: Staff Cross Exhibits 1, 2 and

9 3 will be admitted into the record.

10 (Whereupon, Staff Cross

11 Exhibit Nos. 1 through 3

12 were admitted into

13 evidence.)

14 MR. JACKSON: And I have no redirect.

15 JUDGE HILLIARD: Okay. If there are no more

16 questions for Ms. Gast, then she is excused.

17 Thank you.

18 MR. LANNON: Thank you, Ms. Gast.

19 JUDGE HILLIARD: Moving right along,

20 Ms. Kight-Garlisch is the next witness.

21 Ms. Kight-Garlisch, would you raise

22 your hand to be sworn, please.

1 (Witness sworn.)

2 MR. JACKSON: If I have cross questions, should

3 I sit over there?

4 JUDGE HILLIARD: Yes.

5 MR. JACKSON: Okay.

6 THE WITNESS: I can see him.

7 MR. JACKSON: But I can't see you.

8 MR. LANNON: I think we'll have to turn the

9 camera.

10 MR. JACKSON: Can you see me, Ms. Garlisch?

11 JUDGE HILLIARD: Can you see the attorney for

12 the Company there?

13 THE WITNESS: Yes, I can.

14 JUDGE HILLIARD: Okay.

15 Do you want to begin with the

16 introduction, Michael?

17 MR. LANNON: Staff will call Ms. Sheena

18 Kight-Garlisch to the stand.

19 JUDGE HILLIARD: Ms. Kight-Garlisch has

20 previously been sworn, please introduce her

21 testimony.

22

1 SHEENA KIGHT-GARLISCH,
2 called as a witness herein, having been first duly
3 sworn, was examined and testified as follows:
4 DIRECT EXAMINATION
5 BY
6 MR. LANNON:
7 Q Can you please state your name for the
8 record spelling your last name.
9 A My name is Sheena Kight-Garlisch. My last
10 name is K-i-g-h-t, hyphen, G-a-r-l-i-s-c-h.
11 Q And who is your employer?
12 A I'm employed by the Illinois Commerce
13 Commission.
14 Q And what's your position at the Commission?
15 A I'm a senior financial analyst in the
16 Finance Department of the Financial Analysis
17 Division.
18 Q And did you prepare written exhibits for
19 submittal in this proceeding?
20 A Yes, I did.
21 Q Do you have before you a document which has
22 been marked for identification as Staff Exhibit 4.0

1 and includes Schedules 4.1, 4.3 N and 4.3 P and 4.2 N
2 corrected and 4.2 P corrected?

3 A Yes.

4 Q And did you prepare that document for
5 presentation in this matter?

6 A Yes, I did.

7 Q And do you have any changes to make to
8 that?

9 A No, I do not.

10 Q Do you also have before you a document
11 marked for identification as Staff Exhibit 13.0
12 corrected with Schedules 13.1 to 13.5 and
13 Attachment A?

14 A Yes, I do.

15 Q And did you prepare that document for
16 presentation?

17 A Yes, I did.

18 Q Do you have any corrections to make to
19 Staff Exhibit 13.0 or its attachments?

20 A No, I do not.

21 Q Is the information contained in Staff
22 Exhibits 4.0, schedules and attachments, and 13.0

1 corrected with schedules and attachments true and
2 correct to the best of your knowledge?

3 A Yes, it is.

4 Q And if I were to ask you the same questions
5 set forth in both those exhibits, would your answers
6 be the same today?

7 A Yes, they would.

8 MR. LANNON: Your Honor, I move for admission
9 into evidence Staff Exhibits 4.0 and attached
10 schedules, 13.0 corrected and attached schedules.

11 JUDGE HILLIARD: Objections?

12 MR. JACKSON: No objection.

13 JUDGE HILLIARD: Hearing no objection, Staff
14 direct -- excuse me -- Staff Exhibit 4.0 plus
15 accompanying schedules, and Staff Exhibit 13.0 with
16 accompanying schedules and Attachment A are admitted
17 into the record.

18

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22

1 (Whereupon, Staff Exhibit
2 Nos. 4.0, 4.1, 4.2 N corrected,
3 4.2 P corrected, 4.3 N, 4.3 P,
4 13.0 through 13.5 and
5 Attachment A were admitted into
6 evidence.)

7 MR. LANNON: Thank you, your Honor.

8 JUDGE HILLIARD: The witness is tendered for
9 cross?

10 MR. LANNON: The witness is available for
11 cross.

12 JUDGE HILLIARD: Proceed.

13 MR. JACKSON: Thank you.

14 CROSS-EXAMINATION

15 BY

16 MR. JACKSON:

17 Q Good morning, Ms. Kight-Garlich. My name
18 is Brad Jackson. I represent the Utilities in this
19 matter.

20 Ms. Kight-Garlich, in recommending
21 that the Utilities' rates reflect increased risk by
22 virtue of reduction in the amount of equity in their

1 capital structures, is it your intent to trigger a
2 downgrade of the Utilities' credit ratings?

3 A Not necessarily.

4 Q If the Commission adopted your
5 recommendation on capital structure and a downgrade
6 resulted, would that be an acceptable result in your
7 opinion?

8 A It could be. It depends on what the
9 downgrade is.

10 Q So there could be downgrades that would be
11 acceptable to you?

12 A Yes.

13 Q Would you agree that if Staff's proposed
14 revenue requirement, including capital structure and
15 cost of capital, yielded a lower implied credit
16 rating according to the S&P matrix, that the
17 Commission should increase the equity in the capital
18 structure or ROE of the Utilities?

19 A I'm sorry. Could you rephrase your
20 question.

21 Q Do you agree that if -- taking the Staff's
22 proposed revenue requirement, including your

1 recommended capital structure and Mr. McNally's
2 recommended return on equity, if you then develop the
3 ratios that go into the S&P credit rating matrix and
4 that suggested a lower credit rating than the
5 Utilities currently have, would you agree at that
6 point that the Commission should either increase the
7 equity in the capital structure and/or the return on
8 equity for rate-making purposes?

9 A No.

10 Q Let me direct your attention to your -- the
11 chart on Page 5 of your direct testimony.

12 A Yes.

13 Q And there you're comparing various S&P
14 financial ratios among the Utilities, Integrys Energy
15 and the Gas Group, correct?

16 A Yes.

17 Q And the Gas Group is the proxy group that
18 Mr. Moul and Mr. McNally used to run the models to
19 arrive at recommendations for return on equity,
20 correct?

21 A Yes.

22 Q To your knowledge, has Staff ever used the

1 ROE proxy group also to set the capital structure of
2 the Utility as you have done here?

3 A Subject to check, I believe we have.

4 Q And is it something that you've done in
5 prior cases yourself?

6 A I think I have. I would have to check to
7 make sure.

8 Q Now, the comparison you present on Page 5
9 relies on historical financial information, correct?

10 A Yes.

11 Q And the -- therefore, the ratios presented
12 here would also be historical, correct?

13 A Yes.

14 Q And the three-year average that you use,
15 that's 2007 to 2009; is that correct?

16 A No. It is 2000 -- 2008, 2009 and 2010.

17 Q Thank you.

18 And you're recommending that the
19 Commission take actions in this case that would
20 increase the Utilities' risk from where they are,
21 take them from their present intermediate level to
22 the significant level, correct?

1 JUDGE HILLIARD: Do you have a page in her
2 testimony you're referring to, Counsel?

3 MR. JACKSON: Yeah, I'm still referring to her
4 table on Page 5 of her direct.

5 JUDGE HILLIARD: Okay.

6 THE WITNESS: As I stated in my rebuttal
7 testimony on Pages 6 and 8, the implied ratios
8 indicate that the financial strength would be
9 significant, which is similar, but slightly weaker
10 than the financial strength implied currently, which
11 is intermediate-significant based on the ratios
12 presented on Page 5 of ICC Staff Exhibit 4.0.

13 (Whereupon, there was a
14 change in reporter.)

15 Q Well, at least let me just double-check I'm
16 reading your table on Page 5 correctly then.

17 Let's look at 2010, the Utility's
18 actual ratios and capital ratio translate to an
19 intermediate implied financial risk; is that correct?

20 A That's correct, but the three-year average
21 implies a three-year risk.

22 Q So that's the distinction we are making

1 between intermediate and what you call
2 significant/intermediate?

3 A Yes.

4 Q And the chart or the table on Page 6 of
5 your rebuttal, now this table is not based on
6 historical, but based on the Staff proposed revenue
7 requirement, correct?

8 A Correct.

9 Q It assumes, does it not, that the utilities
10 earn 100 percent of that revenue requirement or the
11 respective revenue requirements?

12 A Yes.

13 Q And at the Utilities' proposed capital
14 structure, their risk would be at the intermediate
15 level; whereas, at the Staff proposed capital
16 structure, their risk would be at the
17 significant/aggressive; is that correct?

18 A No, the risk implied is significant, not
19 significant/aggressive.

20 Q And that's by taking approximately an
21 average of the various risk levels at each of the
22 ratios, is that how you get to that?

1 A If you look at each ratio for North Shore
2 at 50 percent gas, the ratio is 28.1 percent.

3 If you look at the ratings matrix, the
4 range for that ratio is 20 to 30, 30 being where this
5 intermediate-risk level begins, so that is a very
6 strong ratio.

7 The next ratio is 3.2, which is the
8 debt to EBITA and that ratio range is 3 to 4, closer
9 to 3 being the stronger, so it is also an extremely
10 strong ratio.

11 The debt to capital is 50 percent,
12 which is right on the border, 45 to 50 percent is
13 significant, 50 to 60 percent is aggressive, so it is
14 a significant risk, so it is a significant risk.

15 MR. JACKSON: Thank you for those
16 clarifications.

17 I have no further questions.

18 JUDGE HILLIARD: Any redirect?

19 MR. LANNON: Sheena, do you want to talk to me?

20 THE WITNESS: Yeah, I will call you from
21 Hearing Room B.

22 MR. LANNON: All right. I will call you, from

1 Hearing Room B.

2 If we could have a few minutes, your
3 Honor?

4 JUDGE HILLIARD: We'll take a little break.

5 (Whereupon, a recess was taken.)

6 JUDGE HILLIARD: Is there any redirect.

7 MR. LANNON: Staff has no redirect, your Honor.

8 JUDGE HILLIARD: Thank you, Ms. Garlisch,
9 you're excused.

10 (Witness excused.)

11 (Witness sworn.)

12 DAVID E. DISMUKES, Ph.D.,
13 called as a witness herein, having been first duly
14 sworn, was examined and testified as follows:

15 DIRECT EXAMINATION

16 BY

17 MS. LUSSON:

18 Q Good morning, Dr. Dismukes.

19 A Good morning.

20 Q Please state your full name and business
21 address for the record.

22 A My name is David E. Dismukes,

1 D-i-s-m-u-k-e-s. And my address is 5800 Parkins
2 Place Drive, Suite 1F, Baton Rouge, Louisiana 70808.

3 Q You have before you what's previously been
4 marked as GCI Exhibit 4.0, which is your direct
5 testimony in this case on behalf of the People of the
6 State of Illinois, the Citizens Utility Board, and
7 the City of Chicago, as well as Attachments 4.1
8 through 4.14.

9 Were these exhibits prepared by you or
10 under your direction and supervision?

11 A Yes, ma'am, they were.

12 Q Do you have any corrections to make to that
13 testimony at this time?

14 A I had some small errata that I believe you
15 provided to the parties ahead of time.

16 Q And --

17 JUDGE HILLIARD: Excuse me, is your mic turned
18 on, Mr. Dismukes?

19 THE WITNESS: Yes, it is.

20 Can you hear me now?

21 JUDGE HILLIARD: Yes.

22 BY MS. LUSSON:

1 Q Just to be clear, the errata was served on
2 parties previously earlier this week and filed on
3 E-Docket yesterday.

4 If I were to ask you the same
5 questions that appear in that testimony, would your
6 answers be the same?

7 A Yes, ma'am, they would.

8 Q You also have before you a document that's
9 been marked as GCI Exhibit 9.0, the rebuttal
10 testimony of David Dismukes on behalf of the People
11 of the State of Illinois, the Citizens Utility Board
12 and the City of Chicago, as well as Exhibits attached
13 9.1 through 9.6. Were these exhibits prepared by you
14 or under your direction and supervision?

15 A Yes, ma'am, they were.

16 Q And do you have any corrections to make to
17 those exhibits at this time?

18 A There was also a small errata associated
19 with that and it was provided with the errata that we
20 discussed earlier to the parties.

21 Q If I asked you the same questions that
22 appear in Exhibit GCI 9.0 today, would your answers

1 be the same?

2 A Yes.

3 MS. LUSSON: We move for the admission of GCI
4 Exhibits 4.1 through 14, as well as GCI Exhibits 9.0,
5 9.1 through 9.6 and we tender Dr. Dismukes for
6 cross-examination.

7 JUDGE HILLIARD: Objections to the exhibits?

8 MS. KLYASHEFF: No.

9 JUDGE HILLIARD: GCI Exhibits 4.0 with
10 Attachments and Schedules 4.1 to 4.14 and 9.0 with
11 Attachments and Schedules 9.1 to 9.6 are admitted
12 into the record.

13 (Whereupon, GCI Exhibits 4.0
14 with Attachments and Schedules
15 4.1 to 4.14 and 9.0 with
16 Attachments and Schedules 9.1
17 to 9.6 were admitted into the
18 evidence.)

19 JUDGE HILLIARD: Please proceed with your
20 examination.

21

22

1 CROSS EXAMINATION

2 BY

3 MS. KLYASHEFF:

4 Q Good morning, Dr. Dismukes.

5 A Good morning.

6 Q My name is Mary Klyasheff. I'm

7 representing North Shore and Peoples Gas. I believe

8 all my questions are directed to your direct

9 testimony.

10 A Yes, ma'am.

11 Q If we could start on Page 4 of your direct

12 testimony at about Line 84?

13 A Page 4, did you say Line 84?

14 Q Page 4, Line 84.

15 A Yes, ma'am.

16 Q The sentence that begins, "the companies'

17 proposals, and within that sentence, you indicate are

18 inconsistent with the fixed cost recovery of shares

19 included in other gas distribution utility rates?

20 A Yes, ma'am.

21 Q Are you referring to Illinois utilities

22 when you refer to other gas distribution utility

1 rates?

2 A No, ma'am, I was speaking more broadly.

3 Q For Illinois, do you agree that the

4 Illinois Commerce Commission has been moving to

5 increased fix recovery through fixed charges?

6 A Yes, ma'am, that's my understanding.

7 Q For example, for Ameren, they have approved

8 80 percent fixed-cost recovery in the customer

9 charge?

10 A Yes, ma'am.

11 Q And similarly for Nicor Gas?

12 A Yes, ma'am.

13 Q If I may refer to Page 19 of your direct

14 testimony. On Line 409, you refer to decoupling and

15 customers trading delivery service rate certainty for

16 rate uncertainty?

17 A Yes, ma'am.

18 Q Do you agree that the fixed customer charge

19 does not vary with customer usage?

20 A Yes, ma'am, that's right.

21 Q But to the extent fixed costs are recovered

22 through that charge, does that increase rate

1 certainty?

2 A It does.

3 Q And if more fixed costs are recovered
4 through a fixed customer charge, would you expect
5 volumetric service rates to decrease?

6 A Would you repeat that. I'm sorry. I got
7 lost in that.

8 Q If additional fixed costs are recovered
9 through a fixed customer charge, would you anticipate
10 the volumetric service rates would decrease?

11 A Yes, ma'am.

12 Q Also on Page 19, but moving up to Line 400,
13 when you discuss the imposition of a surcharge when
14 sales would fall short of expectations, that piece of
15 your testimony?

16 A Yes, ma'am.

17 Q When you use the term "surcharge," are you
18 referring to the monthly adjustment that happens to
19 reconcile actual activity to two months previous
20 activity?

21 A Yes, ma'am.

22 Q And, likewise, the term "refund" would be

1 that same sort of adjustment?

2 A Yes, ma'am, it would.

3 Q When you talk about falling short of

4 expectations, are the expectations to which you refer

5 the test year sales?

6 A Yes, ma'am.

7 Q So it would be whatever the Commission

8 approved as test year sales would set the

9 expectations?

10 A Well, sales are in the revenue per customer

11 model, whatever that allowed revenue per customer was

12 for that test purpose.

13 Q Whatever the Commission approved for the

14 test year?

15 A Yes, ma'am.

16 Q Moving to Page 33, Line 750 of your direct

17 testimony. You have a parenthetical referenced to

18 commercial and industrial transportation service?

19 A Yes, ma'am.

20 Q Do you have a particular service

21 classification in mind when you refer to that

22 service?

1 A No, ma'am. I don't know what the number
2 was at the current time.

3 At the time it was those tariffs that
4 were relevant to those types of services.

5 Q Nonresidential large-volume-use customers,
6 would that be --

7 A Yes, ma'am that would be one.

8 Q And on Page 32 and 33, you have several
9 percentages referenced here about fixed-cost
10 recovery?

11 A Yes, ma'am.

12 Q And I think one may have been slightly
13 changed in your errata.

14 A Right.

15 Q These are the percentages based on cost
16 recovery in the customer charge; is that correct?

17 A From the customer charge revenues, yes,
18 ma'am.

19 Q In preparing your testimony, did you review
20 other sorts of charges that nonresidential customers
21 may pay?

22 A No, ma'am.

1 Q Can I refer to your Exhibit 4.13, and let's
2 turn first to Page 1.

3 A Okay.

4 Q In the middle of that page, roughly, is a
5 reference to S.C.4, Service Classification 4.

6 A Yes, ma'am.

7 Q And the second charge on the list is a
8 demand charge.

9 Do you consider demand charges to be
10 fixed charges?

11 A Not necessarily, those are charges that
12 will vary based on the demand of the individual
13 customers.

14 Q Would they vary based on the customer
15 usage?

16 A It would -- they would vary on that
17 customer's demand, the demand.

18 Q How would you expect the demand level to be
19 set?

20 JUDGE HILLIARD: Could you try to raise your
21 voice a little. I'm having trouble.

22 THE WITNESS: I'm sorry.

1 As it's measured through those demand
2 charges that are sedentary, depending on the fixed.

3 Q If a rate for customer has its demand level
4 set based on let's say peak usage?

5 A Right.

6 Q Would you expect then the charge to be
7 applied to that peak usage number of that demand
8 level?

9 A Yes, ma'am.

10 Q For Rate 4 for Peoples Gas, is it correct
11 that under proposed rates, 49.1 percent of the base
12 rate revenue would be recovered through the demand
13 charge?

14 A Yes, ma'am.

15 Q Then if we could turn to Page 2 of the
16 exhibit, which is similar data for North Shore and
17 referring here to Service Classification No. 3, which
18 the second charge down is also a demand charge.

19 For these Rate 3 customers, is it
20 correct that 63 percent of the base rate revenue
21 would be recovered through the demand charge?

22 A Yes, ma'am.

1 Q In your analysis about fixed-cost recovery,
2 did you take proposed Rider SSC into account?

3 A No, ma'am, I did not.

4 Q I would like to jump briefly back to Page
5 33 of your direct testimony.

6 The bottom of that page carrying over
7 to Page 34, you testify about under Company's cost
8 base rationale the monthly rate for certain customers
9 could be over \$7,000 for Peoples and North Shore?

10 A Yes, ma'am.

11 Q Is that part of your testimony?

12 A Yes, ma'am.

13 Q Did you base those calculations on
14 Company's cost-of-service study?

15 A Yes, ma'am.

16 Q And did you use data from Schedule E5 in
17 those calculations?

18 A Yes, ma'am.

19 Q So it's your understanding that Schedule E5
20 is cost-of-service study?

21 A That's what I believe the rate model of the
22 cost of service are linked into the formulated rates.

1 Q Did you review Schedule E6 when you made
2 the calculations, do you recall?

3 A I don't recall.

4 MS. KLYASHEFF: I have no further questions.
5 Thank you.

6 JUDGE HILLIARD: Redirect?

7 MS. LUSSON: Just one minute please.

8 (Off the record.)

9 We have no redirect.

10 JUDGE HILLIARD: Thank you, sir. You're
11 excused.

12 (Witness excused.)

13 JUDGE HILLIARD: I suppose you're going to do
14 Mr. Moul and then --

15 MR. LANNON: Your Honor, if I could suggest,
16 Mr. McNally and Mr. McGosin (phonetic) are on their
17 way here, they should be here somewhat shortly, but
18 maybe if we could take an early lunch and come back
19 early, we would like to have them here for Mr. Moul.

20 JUDGE HILLIARD: Okay. Anybody have a problem
21 with that?

22 (No response.)

1 Reconvene at 12:05, something like
2 that.
3 MR. LANNON: Thank you, your Honor.
4 (Whereupon, a lunch recess
5 was taken.)
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AFTERNOON SESSION

(Witness sworn.)

PAUL R. MOUL,

called as a witness herein, having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY

MR. JACKSON:

Q State your name for the record, please.

A My name is Paul Ronald Moul, M-o-u-l. The pronunciation rhymes with the word "owl."

Q And what's your business address?

A 251 Hopkins Road, Haddonfield, New Jersey, 08033.

Q Mr. Moul, in connection with this testimony, did you prepare two pieces of direct testimony, which have been marked NS Exhibit 3.0 and PGL Exhibit 3.0?

A I did.

Q Do you have a correction to each of those pieces of testimony?

A Yes, I do.

1 The correction is the same, the page
2 and line numbers vary slightly.

3 I'm looking at Peoples Gas Light
4 Page 30, Line 674 and for North Shore, the same
5 correction applies to Page 31, Line 675.

6 The second word in that row says
7 Appendix F and the correct reference in the case of
8 Peoples would be PGL EX.3.13D. The corresponding
9 correction for North Shore would be NS EX.3.13D.

10 Q Mr. Moul, in connection with those pieces
11 testimony, did you also prepare the exhibits that
12 have been marked NS3.1 through 3.13 and PGL Exhibit
13 3.1 through 3.13?

14 A I did.

15 Q Do you have any corrections to the
16 exhibits?

17 A Not that I'm aware of at this time.

18 Q You also prepared written prefiled rebuttal
19 testimony marked NS/PGL Exhibit 3.19.0?

20 A I did.

21 Q Do you have any corrections to that
22 testimony?

1 A I have two in that piece of testimony.

2 The first one is on Page 18, Line 367,

3 sort of towards the end of that row there is a

4 reference to 3.25, and the correct reference should

5 be 19.12. In both instances they're Exhibit numbers.

6 JUDGE HILLIARD: 19.12.

7 THE WITNESS: 19.12, correct, your Honor.

8 The second one is on Page 25 at

9 Line 524, the fifth word in there says "tracking," it

10 should be "trading."

11 MR. REDDICK: Was that "treating" or "trading"?

12 THE WITNESS: Trading, t-r-a-d-i-n-g.

13 BY MR. JACKSON:

14 Q In connection with that piece of testimony,

15 did you also prepare the exhibits that have been

16 marked NS/PGL 19.01 to 19.02?

17 A Yes, I did.

18 Q Finally, did you also prepare a prefiled

19 written surrebuttal testimony marked NS/PGL Exhibit

20 36.0?

21 A I did.

22 Q Do you have any corrections to that piece

1 of testimony?

2 A Not that I'm aware of at this time.

3 Q Mr. Moul, if I asked you the questions
4 contained in the prefiled direct, rebuttal testimony
5 and surrebuttal testimony, would your answers be the
6 same as corrected today?

7 A They would.

8 MR. JACKSON: Your Honor, I seek the admission
9 of NS Exhibits 3.0 to 3.13, PGL Exhibits 3.0 to 3.13,
10 NS/PGL Exhibits 19.0 to 19.12 and NS/PGL Exhibit
11 36.0.

12 JUDGE HILLIARD: Objections?

13 (No response.)

14 Hearing no objection, Exhibits 3.0 for
15 Peoples and 3.0 for North Shore and the various
16 attachments and schedules will be admitted, same for
17 Exhibit 19.0 and Exhibit 36.0 and the corrections
18 will be noted.

19 MR. JACKSON: Thank, your Honor. I understand
20 we need to file an errata and we will do that.

21 JUDGE HILLIARD: Good.

22 MR. JACKSON: The witness is available for

1 cross-examination.

2 (Whereupon, NS
3 Exhibits 3.0, 3.13 to
4 PGL Exhibits 3.0 to
5 3.13, NS/PGL Exhibits
6 19.0 to 19.12 and
7 NS/PGL Exhibit 36.0
8 were admitted into
9 evidence.)

10 CROSS EXAMINATION

11 BY

12 MR. REDDICK:

13 Q Good afternoon, Mr. Moul. My name is
14 Conrad Reddick, and I represent the City of Chicago.
15 My questions generally go to your
16 general overall approach to determining the cost of
17 equity.

18 Let me start by asking, do you
19 consider the equity markets an economically efficient
20 mechanism; that is one that absorbs and acts on
21 information in an economically rational manner?

22 A Overall and generally speaking, I would

1 agree with that. There are clearly exceptions,
2 however.

3 Q And do you agree that as a result, data
4 from equity market transactions are reliable
5 indicators of the information that is available to
6 the market?

7 A Same response: Generally I would agree
8 with that, but there are clearly exceptions.

9 Q There is a term you use often in your
10 testimony, "investor expectations," and I'd like to
11 clarify what you mean by that.

12 Do you use the term as Mr. Thomas
13 defines it in his testimony as shorthand for the
14 aggregated effects of all investors' investment
15 decisions as indicated by the objective market data?

16 A I haven't looked at each instance where I
17 use that term to know whether I would agree with
18 Mr. Thomas as to the meaning in each and every
19 instances.

20 There are instances where I would
21 agree with that and I'm sure there is other instances
22 where I deviate from that definition.

1 Q Where would that definition not apply?

2 A Well, again, I haven't gone through and
3 picked out each instance where I used that term, but
4 as I understand Mr. Thomas' testimony, he's using
5 that term more as a term of art, and I do that, too,
6 but I also use the term in a more general context
7 insofar as the plain meaning of the words go.

8 Q That is the ordinary dictionary meaning of
9 words?

10 A Yes, auh-huh.

11 Q So when you say "in those instances"
12 investor expectations, you mean what investors
13 subjectively expect to happen?

14 A Well, it doesn't have to be subjective.

15 You can measures what those
16 expectations are, but they wouldn't always need to be
17 based upon a hard data set.

18 Q They're not subjective, but they're not
19 based on hard data sets; is that what you said?

20 A Yes.

21 For instance, I use investor
22 expectations in the context of the type of

1 information investors would accumulate and digest in
2 making investment decisions, but those would relate
3 to, say, overall market sentiment and those types of
4 things that may not limit itself to quantification.

5 Q What does "market sentiment" mean?

6 A In the common vernacular a bull market or a
7 bear market.

8 Q And are you saying bull markets and bear
9 markets are not defined by objective data?

10 A Well, it's more or less in the eyes of the
11 beholder, sure.

12 I mean the question is, for instance,
13 right today, we've gone through an enormous fall off
14 in stock prices, okay, so is that a bull market
15 correction or is it the beginning of a bear market?
16 I can't tell you that.

17 We might be able to tell when we get
18 two or three or five or ten months down the line
19 whether we've just gone through a bull market
20 correction or the beginning of a bear market, but I
21 can't tell you that today.

22 Q So that's not something this Commission

1 could rely on?

2 A Sure, it can. It can rely on that.

3 Q You can't tell that to this Commission,
4 though?

5 A You're not setting rates based upon, I will
6 call them anomalous events. You're looking to set
7 rates on a more normalized set of facts and
8 circumstances.

9 Q And when you say "normalized events," do I
10 understand you correctly to say that one takes the
11 results of the financial models using objective
12 market data and somehow normalizes them?

13 A That's the role of an analyst, sure, to
14 take the data and use it -- I think the terminology
15 we see in these proceedings often, you use the
16 informed judgment in taking both the raw data and
17 using it in the models that we have to come up with
18 the measure of the cost of equity, and then once you
19 have the results, it may require additional informed
20 judgments to see if it makes common sense.

21 Q So if I understand correctly -- well, let
22 me take it one step at a time.

1 I've most often heard the expert
2 analysts' judgment employed in the selection and
3 definition of input data to the models, you mean --
4 should I repeat that?

5 A I just didn't catch the one term.
6 "Something or other data"?

7 Q I had heard that the phrase "analyst
8 judgment" used in the selection of input data --

9 A Oh, "input."

10 Q -- to financial models.

11 Are you saying that there are
12 instances where you apply judgment beyond the input
13 to the models?

14 A Oh, sure. Regulators do it all the time.

15 Q Okay.

16 A They not only look --

17 Q I just asked about you.

18 A Yes, I do do that.

19 Q And you employ this judgment with respect
20 to the results of the models, not just the inputs?

21 A Correct.

22 Q So after you have run your models and you

1 have a result you use your impressions of the market
2 sentiment to make adjustments as you see fit to the
3 results of the models?

4 A I do that, plus I might do -- make
5 additional judgments as to the reliability of the
6 final outcomes, and you can do that by looking at
7 outcomes of other models, outcomes of the similarly
8 applied data with different groups. There are a
9 variety of ways you can accomplish that.

10 Q As I read your testimony, it seems to me
11 that what you appear to use as the standard of common
12 sense is the results of determinations by other
13 commissions for other utilities.

14 Is that accurate or a fair summary of
15 your approach?

16 A That's a partial explanation of my
17 approach.

18 I did that in my rebuttal. I didn't
19 do it as part of the direct case.

20 In the direct case, what I did is I
21 looked at results of specific models and tested to
22 see whether they made sense vis-a-vis application of

1 the same models with different proxy groups, and also
2 the results vis-a-vis the outcome results of other
3 models.

4 Q But in the sections where you discuss
5 common sense, my recollection is that your reference
6 was to the results summarized in your Exhibit 19.01.
7 Is that accurate?

8 A Well, that's part of it, but that wasn't
9 solely the way you would apply common sense to see
10 whether the output or the results of the models
11 fulfill the standard requirements of a fair rate of
12 return.

13 I mean, common sense is part of the
14 regulatory process.

15 Q And the requirements of the regulatory --
16 I'm sorry. I missed the phrase you used.

17 A "The regulatory process."

18 Q The regulatory process for determining a
19 return would be a return that commensurate with
20 enterprises of a similar risk?

21 A Yes, and the other principle is the end
22 result test.

1 I believe one of the two famous
2 Supreme Court decisions indicated that, what's
3 important isn't how you get there, but whether the
4 end result provides a fair opportunity for the
5 utility to recover its costs.

6 Q Which emphasizes again the standard for
7 determining whether or not that's a fair return or
8 common sense return?

9 A Yes.

10 The standard isn't -- you can't get
11 caught up too much -- well, you have to go through
12 the process -- but you need to look at the results of
13 the models to see if they fulfill the end results
14 test for fulfilling a fair return.

15 Q So you would not agree, then, that the
16 Commission's reliance on the results of financial
17 models alone would be an adequate method of
18 determining the cost of equity?

19 A I want to respond to your question, but I
20 would say that's the starting point, that's not the
21 ending point.

22 Q Okay.

1 A The Commission clearly has to see the
2 evidence and see the results of the models and look
3 at the models, but that's not the end point, that's
4 the beginning of the process.

5 Q So having run the financial models using
6 objective market data, we then look at the result and
7 see if its -- see if we like it?

8 A Well, we'll see if it makes sense vis-a-vis
9 other models similarly applied data with other proxy
10 groups of companies and see what is being done in the
11 regulatory arena generally.

12 There is lots more that needs to be
13 done after you come up with the results of the
14 models.

15 Q Let's look at the data set you use as a
16 standard for assessing common sense.

17 That's Exhibit 19.01, if you want to
18 look at it.

19 A I have it.

20 Q Am I correct, based on what you just told
21 us, that it is your intention that the Commission's
22 decision-making should be affected by the comparisons

1 you offer in Exhibit 19.01?

2 A I agree with that entirely. It should be
3 affected by it. This should not be the basis for it,
4 but certainly should have an influence on the
5 following determination.

6 Q You believe them to be useful comparisons?

7 A Yes, because to provide a return equivalent
8 to other enterprises of similar risk, these are the
9 kinds of returns those similar risk enterprises are
10 being provided.

11 Q This is part of your determination of the
12 recommendation that you made?

13 A It wasn't submitted until the rebuttal
14 part. It wasn't part of my direct case. I used
15 other techniques to apply common sense to the results
16 of the outcomes, but when we got to the rebuttal
17 stage, this was part of it, yes.

18 Q That exhibit shows certain statistical
19 calculations, averages over the period of the
20 exhibit.

21 I think it's at the bottom of the last
22 page.

1 A Right.

2 Q Given the nature of those statistical
3 calculations, isn't it true that the calculated
4 number would trail the current market whether there
5 was an increasing trend or decreasing trend simply
6 because of the nature of the averages?

7 A I would agree with that, that's right,
8 because these determinations by this and other
9 Commissions were based upon a record developed in
10 those cases which would predate the final
11 determination.

12 I agree with that.

13 Q And the list in 19.01 includes electric, as
14 well as gas utilities?

15 A Yes, sir.

16 Q And some of the electric utilities are in
17 the generation business, as well as the distribution
18 business?

19 A Yes, sir.

20 Q Did you exclude the electric utilities from
21 your calculation of the mean and median returns?

22 A No, sir, because even if an electric

1 utility is fully integrated as generation, that
2 generation is subject to regulation, just like the
3 delivery part of the business is subject to
4 regulation.

5 Q And isn't it true that some of the returns
6 shown on your exhibit are almost three years old?

7 A I think they're maybe two years old.

8 Q I think the oldest one is dated 1/29/09?

9 A 1/29 -- let me take a quick look at that.
10 I'm not putting my finger on that real quick, but I
11 certainly accept that.

12 Q It's on the first page, a little way
13 halfway down.

14 A 1/29/09, it's two years and eight months
15 old.

16 Q Thank you.

17 And the test year in this case is
18 2012?

19 A Yes, sir.

20 Q Is it true that included in this list are
21 cases where the results were -- let me start over and
22 restate it clearly.

1 Is it true that some of the cases
2 shown in your exhibit were reached through
3 settlement?

4 A Yes, sir.

5 Q And is it also true that in at least some
6 of those settlement approvals, the Commission did not
7 make an expressed determination of the cost of
8 equity?

9 A I agree that they did not make the
10 determination, but they endorsed what the settlement
11 came up with. I mean, they accepted it.

12 Commissions don't always accept every
13 settlement that's presented to it, but these were
14 accepted settlements. I agree with that.

15 Q Do you know whether all of the reported
16 settlements were unanimous, more specifically whether
17 they included the agreement of ratepayer advocates?

18 A I cannot tell you that.

19 I do know from personal experience
20 that some settlements go up to commissions as
21 contested settlements, and the Commission will accept
22 the settlement and make whatever determination it

1 needs to.

2 Q Did you investigate the particulars of the
3 returns you show as based on settlements; that is,
4 whether the return was increased or decreased as a
5 result of some factor in the settlement?

6 A Some factor that?

7 Q That was a part of the settlement?

8 A I don't understand that question.

9 Q Did you investigate whether the approved
10 return was affected by another element of the
11 settlement?

12 A I'm sure they all are. I mean, that's the
13 nature of the settlement.

14 When you settle a case, as I
15 understand it, there is tradeoffs, and they might
16 tradeoff a lower return for additional project
17 included in the rate base and vice-versa. That's the
18 nature of settlements.

19 Q Have the settlements been excluded from
20 your median and mean calculations?

21 A No.

22 Q Do you know how many of the reported cases

1 involved offsets, rate freezes or other actions that
2 were required as conditions of the return award?

3 A I'm sorry. I'm having trouble hearing your
4 question.

5 Q Offsets, rate freezes or other actions?

6 A I'm sure there is some.

7 New York is notorious for engaging in
8 multi-year settlements. They don't necessarily
9 involve rate freezes, they're typically step
10 increases during the settlement period.

11 Q But we're pretty sure there are some that
12 were affected by settlement conditions?

13 A I agree with that.

14 Q Yeah, and we don't know what those
15 conditions were?

16 A No, you have to look at each settlement
17 agreement to make that determination.

18 Q And you didn't do that?

19 A Some of them I did because I was involved
20 in the cases, but not all of those.

21 Q Okay. And were those cases, the settlement
22 cases, excluded from your mean and median

1 calculations?

2 A No.

3 Q In your testimony, you testified that size
4 is a factor that should be taken into the account in
5 determining the cost of equity.

6 Am I correct that the utilities you
7 show on Exhibit 19.01 are not of uniform size?

8 A I agree with that.

9 Q Your exhibit does not provide size
10 information, does it?

11 A No.

12 Q And you did not adjust the return shown on
13 the exhibit based on the relative sizes of the
14 utilities, did you?

15 A No.

16 Q Does your exhibit indicate whether the
17 approving Commission had already taken size into
18 account when it approved the return shown?

19 A I couldn't answer that.

20 Q Do you know whether any of the reported
21 returns incorporated upward adjustments that this
22 Commission has rejected in the past?

1 A Oh, that's a tough question. I don't think
2 I can answer that. I don't know.

3 Q So that any potential difference there
4 wasn't something you took into account when you made
5 your calculations?

6 A No, because we all know that this
7 Commission likes to look at DCF and CAPM, and there
8 is some orders in here, the commissions do follow
9 that process. Some jurisdictions favor one model
10 over another and apply the models differently than
11 what might be done here.

12 Q One of the cases shown in your exhibit
13 included a 50-basis point downward adjustment for
14 the, as shown in the exhibit: "Reduced risk
15 associated with a revenue decoupling mechanism."

16 Is that comparable information this
17 Commission should consider in making its
18 determination in this case?

19 A Not in this case, no, because that
20 adjustment was made when decoupling was first
21 implemented, and here we already had decoupling in
22 place for quite a number of years, and those types of

1 adjustments are typically made when -- when
2 decoupling is implemented in recognition of change in
3 risk from not having decoupling to coupling, so the
4 circumstances are different.

5 Q Are you saying that after a period of time,
6 there is no need to make an adjustment because the
7 market has taken that into account already?

8 A Sure, that would be one thing, or you can
9 measure the cost of equity with proxy companies
10 that's already have decoupling, which is becoming an
11 increasingly common approach to deal with the risks
12 of the implications of decoupling.

13 Q And it would be relevant in those
14 circumstances to determine whether the decoupling
15 mechanisms were pretty much the same?

16 A I agree with that.

17 Q Did you make an assessment of how many of
18 the cases listed involved utilities of comparable
19 risks to Peoples Gas or North Shore Gas?

20 A Some of them, sure, because I worked on
21 some of these cases.

22 Q The question was: Did you make a

1 determination of how many of the cases listed --

2 A No, not.

3 Q --involved utilities of comparable risk.

4 A No, I did not do that.

5 Q So you did not assess the riskiness of each

6 of the utilities included in this list?

7 A No, this was an overall view of what

8 regulators nationally are granting regulated gas and

9 electric utilities. It's not intended to be anything

10 more than that.

11 Q How many of the companies on this list were

12 included in your proxy group of comparable companies?

13 A I know there is some because I keep saying

14 Atmos pop up on this list. The only one that jumps

15 out at me is Atmos, but there might be some others.

16 I haven't looked at each entry.

17 Q How many companies are in your proxy group?

18 A Isn't eight?

19 Q I believe that's correct.

20 A Hang on let me just check to make sure that

21 I'm stating that correctly. Yeah, eight.

22 Q So at most, eight of these companies were

1 companies you identified as being comparable to
2 Peoples Gas and North Shore Gas?

3 A Correct.

4 Q Mr. Moul, do you agree that there is a
5 distinction between market required return and
6 subjective investor expectations?

7 A Can I have at that question back again
8 please.

9 Q I can just repeat it.
10 Do you agree that there is a
11 distinction between the market required return and
12 the subjective investor expectations?

13 A I don't see how you're connecting those two
14 concepts in that question.

15 The market required return is whatever
16 it is we measure using that type of data. And
17 investor expectations are something that give rise to
18 the market required return.

19 So maybe I'm just not understanding --
20 maybe I just don't know enough about your question to
21 answer it.

22 Q I think you said fairly forcefully they are

1 distinct.

2 A One becomes -- I don't know if I want to
3 say this, but one almost becomes an input into the
4 other, the expectations are an input into what you
5 come up with as the market requirement return.

6 Q I would like to see if we can figure out
7 exactly what each of us means. I would like to
8 explore some hypotheticals with you.

9 If investors expect a 10.5 percent
10 return, but would invest in a utility of a certain
11 riskiness for 9.9 percent return, which is the return
12 the Commission should order?

13 A I don't think a rational investor would do
14 that. If his expect of return is 10 and a half, he
15 would only invest if he could get 10 and a half out
16 of that investment.

17 Q Assume that financial models based on
18 current market data showed a risk base cost of equity
19 for North Shore and Peoples Gas of 9 percent, suppose
20 further that investors as a group, thought the North
21 Shore and People Gas management teams were absolutely
22 terrific and they expected that the companies would

1 actually earn 10 and a half percent, which of those
2 returns should the Commission approve?

3 A I don't see in your question what
4 distinction you're trying to get me to draw.

5 You said to me -- seeking me to pick
6 one of two returns, but I don't think your question,
7 at least to me, doesn't make sense as to why
8 investors would deviate from their required return.

9 Q So which number is that?

10 A It's whatever the market says is the
11 required return.

12 In your example, if I understood the
13 example correctly, it would have been 9 percent.

14 Q Okay. Did you review Mr. Thomas' rebuttal
15 testimony?

16 A Yes, sir.

17 Q And do you recall that he had in his
18 testimony a hypothetical about state of Alaska
19 guaranteeing returns for utilities.

20 Do you recall that?

21 A I do.

22 Q You do?

1 A Oh, I recall it quite well.

2 Q Okay.

3 A I just testified in Alaska last week, so
4 I'm quite familiar with it.

5 Q Just in case the judges are not familiar
6 with it, this is the page from Mr. Thomas' testimony.

7 Now, that hypothetical, it describes a
8 situation where a utility was assured of a certain
9 return where investors expected that level of return
10 and that the guarantee was provided by an entity that
11 could obtain capital at a cost far below the expected
12 guaranteed return.

13 You did not discuss this in your
14 surrebuttal testimony, but I'd like to get your take
15 on that.

16 In that situation, what is the risk
17 based cost of equity in that hypothetical?

18 A That hypothetical made absolutely no sense
19 to me.

20 Q So you --

21 A Because I couldn't see the logic of some of
22 the assumptions in the hypothetical.

1 Q I understand.

2 A It was illogical.

3 Q I understand. That's why we have

4 hypotheticals.

5 A Okay.

6 Q So it makes no sense to you at all. You

7 cannot answer that question?

8 A No.

9 Q Okay.

10 A That hypothetical just makes no sense.

11 Q Okay. Let's try to make find something

12 that does make sense to you.

13 Suppose investors read Peoples Gas

14 testimony in this case asserting that despite past

15 Commission orders determining specific risk based

16 returns based on financial models, the companies have

17 earned less than their authorized returns, and as a

18 result investors actually expect the companies to

19 earn less than the models indicate in this case,

20 should the Commission approve the equity return lower

21 than the models results in this record?

22 A In that circumstance, I would say yes,

1 because regulatory agencies have granted increments
2 to the return in the case regulatory attrition
3 (phonetic) and that causes the utility to
4 underachieve its authorized return. I have seen
5 that.

6 Q Do you agree that the Commission's
7 objective in this case is to determine the
8 appropriate return for the utilities, Peoples Gas and
9 North Shore Gas?

10 A I agree with that.

11 Q And that its focus is on the returns that
12 those utilities earn rather than the return that
13 investors earn on their stock purchases?

14 A Well, we are using one to come up with the
15 opportunity for the other.

16 Now, keep in mind, there is a big
17 distinction between the opportunity that the
18 Commission provides in its rate case decision of
19 which the cost of equity is a key ingredient and what
20 the utilities are actually able to earn due to a
21 whole host of factors.

22 Q Well, my question went to a distinction

1 between earnings by the utilities and earnings by
2 investors.

3 That is the return an individual
4 investor might earn could be different from the
5 return the utility earns?

6 A I agree with that.

7 Q And you also agree that under rate of
8 return regulation, there is no entitlement for an
9 individual investor in utility equity securities to
10 earn any particular return?

11 A I'm having trouble with your question.

12 Are you asking about the utility or
13 the investor?

14 Q The investor.

15 Basically, the rate of return doesn't
16 reach that far?

17 A Absolutely not. The regulatory process
18 doesn't guarantee investors any particular return,
19 the market establishes that return.

20 Q For example, the fact that an investor may
21 buy a utility's shares at a price above what he can
22 later sell them for does not require that this

1 Commission allow the utility to earn only a negative
2 return?

3 A I'm not with you.

4 Q All right. I will skinny it down.

5 If investors lose money buying Peoples
6 Gas shares, that does not mean the Commission has to
7 approve a negative return for Peoples Gas?

8 A No.

9 Q Okay. Similarly, if an investor earns less
10 than he expected from his investment in utility
11 shares, that doesn't require this Commission to match
12 a low return for investors with a low return
13 authorization for the utility?

14 A No, unless the regulatory process is
15 through -- and again, this is the end result idea,
16 the totality of the regulatory process is denying the
17 utility the opportunity to actually achieve what the
18 Commission says is fair.

19 Q There is a constitutional floor, I think we
20 can both agree on that.

21 A Yes.

22 Q And it is possible that a utility can earn

1 its authorized return even though the main investors
2 and individual investors in the market don't earn
3 what they expected on the utility investments they
4 made?

5 A I agree with that.

6 Q I believe you mention in your testimony
7 that you have participated in three successive
8 Peoples Gas/North Shore rate cases.

9 Over what period of time was that?

10 A The first rate case was in 2007, the second
11 2009, and this one in 2011.

12 Q About four years, five years?

13 A Five, I guess.

14 Q And has the Commission applied authorized
15 returns book value consistently over that time
16 period?

17 A No, I don't believe they have.

18 I think the Commission has been
19 flexible in the methodology it has used to set the
20 return and they do vary from case to case.

21 Q Could you give me an example of where the
22 Commission did not apply the returns to book value?

1 A I'm sorry.

2 Q Where the Commission did not apply the
3 return it authorized to the book value?

4 A Oh, that's a different question. Oh, I
5 agree with that.

6 Q I'm sorry. Perhaps, I didn't phrase it
7 clearly.

8 The question was: Whether the
9 Illinois Commerce Commission has applied the returns
10 it authorizes to book value consistently over the
11 period you've been involved in Peoples Gas cases?

12 A I agree with that.

13 Q Okay. And you have proposed an adjustment
14 based on the market capital structure in each of
15 those cases?

16 A Yes, sir.

17 Q And each time the Commission has rejected
18 that adjustment?

19 A Yes, they have, and I keep trying to come
20 up with a better explanation of what I'm proposing
21 because I'm not always convinced that its fully
22 understood.

1 Q I understand.

2 Well, the question then is: Do you

3 believe that investors in the equity markets haven't

4 yet caught on to that Commission applies its

5 authorized returns to book values?

6 A Oh, they know that.

7 Q Okay.

8 A I mean, in this jurisdiction or any other

9 original-cost jurisdiction.

10 Now maybe in fair-value jurisdictions,

11 there may be a variation from that, but I generally

12 agree with you.

13 MR. REDDICK: Thank you, Mr. Moul.

14 No other questions.

15 JUDGE HILLIARD: Okay.

16 John?

17 CROSS EXAMINATION

18 BY

19 MR. FEELEY:

20 Q Good afternoon, Mr. Moul. I didn't hear

21 the way you pronounce your name.

22 A The way I pronounce it, it rhymes with the

1 word "owl," but based on will spelling, you would
2 never get that out of it.

3 Q Good afternoon, Mr. Moul. My name is John
4 Feeley. I represent the Staff.

5 If I could direct your attention to
6 your direct testimony, on Page 3 around Line 54?

7 A I have that.

8 Q In your testimony there, you note that the
9 companies, and you're talking about the North Shore
10 and Peoples Gas and the other, that the companies'
11 stock is not traded; is that correct?

12 A Yes, sir.

13 Q Do Peoples Gas and North Shore have market
14 values?

15 A No, because they're stock's not trading.

16 Q So your opinion is that because their stock
17 is not traded, there is no market value for the
18 companies?

19 A There's no active market in their
20 securities, so you cannot go to the Wall Street
21 Journal or online or anywhere else to get a quoted
22 stock price for Peoples Gas Light and Coke or North

1 Shore Gas.

2 I mean, there is a market value -- I
3 mean, if Integrys decided that they wanted to sell
4 either/or both of these companies, a willing buyer
5 and a willing seller would come up with a quote
6 market value for them.

7 Q Okay. So they have market value leverages;
8 is that correct?

9 A I don't understand the question.

10 Q Well, in terms of their book value, can the
11 market value be greater than the book value or less
12 than the book value?

13 MR. JACKSON: I can't hear what the question
14 is. BY MR. FEELEY:

15 Q You said you didn't understand the term
16 "market value leverages."

17 My question to you is: In terms of
18 the book value, could the market value be greater
19 than the book value or equal to the book value or
20 less than the book value?

21 A Theoretically, it would. That's why we use
22 proxy groups in companies in the situation of Peoples

1 around North Shore because we don't have a stock
2 price to look at.

3 If these companies had stock that was
4 traded, we would look at those praise prices, since
5 we don't have that, that's why we go out and pick out
6 a proxy group and we use them as a stand-in for what
7 the stock would be if it was traded, but
8 unfortunately, it is not.

9 Q What's your estimate of the cost of equity
10 for the gas group?

11 A Well, in my direct testimony, I came up
12 with a cost of equity recommendation of 11.25 and
13 then --

14 Q I'm sorry. What page are you looking at?

15 A Page 5, Line 195, 11.25.

16 Then I reduced that. I'm looking at
17 Exhibit 19, Line 146, I reduced that 40 basis points
18 to 10.85.

19 Q Would you agree that the market values of
20 the common equity of the companies in your samples
21 are a direct function of how much money they earn?

22 A That's part of it. Generally, market

1 sentiment has something to do with it.

2 Q So, yes --

3 A Yes, in part.

4 Replacement costs of the facilities
5 has something to do with it. There is lots of
6 factors that bear on that, but you've hit one of
7 them.

8 Q Okay. Do you agree that how much the
9 companies in your samples earn is a direct function
10 of the authorized rate of return on rate base?

11 A Yes, it has a big influence on it.

12 Q In your years of financial consulting, you
13 testified in jurisdictions across the country,
14 correct?

15 A Yes.

16 Q And I think on Page 2 of your Exhibit 3.1,
17 I think you identified 34 state public utility
18 commissions that you testified in; is that correct?

19 A Yes, sir.

20 Q In how many jurisdictions did you not feel
21 it necessary to present a leverage adjustment because
22 a market-value rate base was used?

1 A I don't know that I could respond to that
2 question relative to that particular factor, but
3 there are instances where I do not apply the leverage
4 adjustment, maybe not for that factor, but there are
5 other instances where I don't use it. I only use it
6 when it's appropriate.

7 Q Can you point to any of those, other than
8 to say that you might have done it?

9 A Sure.

10 Last year, I did a case in Indiana for
11 Northern Indiana Public Service, NIPSCO, and I did
12 not apply a leverage adjustment there because its
13 book value equity ratio was so close to the
14 market-value equity ratio of the proxy group, it
15 didn't warrant an adjustment.

16 So I'm not trying to quarrel with your
17 question, but to let you know that there are
18 instances where I don't use the adjustment, but maybe
19 not for the reason you cited.

20 MR. FEELEY: Can I approach the witness?

21 JUDGE HILLIARD: Yes.

22 BY MR. FEELEY:

1 Q Mr. Moul, I'm going to hand you to what I
2 marked as identification as ICC Staff Exhibit Cross
3 Exhibit No. 4.

4 (Whereupon, there was a change
5 of reporters.)

6 BY MR. FEELEY:

7 Q Mr. Moul, I have marked for identification
8 as ICC Staff Cross Exhibit No. 4, your response to
9 Staff Data Request MGM 4.11.

10 Do you have that front of you?

11 A I do, yes, sir.

12 Q And do you intend that response set forth
13 in ICC Staff Exhibit No. 4 to be the answer to the
14 question posed in MGM Staff Data Request 4.11?

15 A Yes, sir.

16 MR. FEELEY: Your Honor, I move to admit into
17 evidence ICC Staff Cross Exhibit No. 4.

18 JUDGE HILLIARD: Objections?

19 MR. JACKSON: No.

20 JUDGE HILLIARD: Staff Cross Exhibit 4 will be
21 admitted into the record.

22

1 (Whereupon, Staff
2 Cross Exhibit No. 4
3 was admitted into
4 evidence.)
5 BY MR. FEELEY:
6 Q Okay. Mr. Moul, I think you indicated that
7 this is your third Peoples Gas-North Shore Gas rate
8 case that you've testified in?
9 A Yes, sir.
10 Q Okay. And you've testified before the
11 Commission in other matters involving other
12 utilities; correct?
13 A I have. I've testified in some water
14 cases.
15 Q Okay. Do you recall testifying in a Docket
16 No. 00-0340, which involved Illinois-American Water
17 Company and it was a rate case before the ICC?
18 A I believe I did a case maybe even two for
19 them. I don't recall the docket numbers.
20 MR. JACKSON: Could I get the docket number
21 again, please?
22 MR. FEELEY: Pardon?

1 MR. JACKSON: Could I get the docket number
2 again, please?

3 MR. FEELEY: Docket No. 00-0340.

4 Maybe I could hand you something --

5 I'm not going to mark this as a cross
6 exhibit, your Honor.

7 BY MR. FEELEY:

8 Q Let me know when you've had a chance to
9 look that over. I think Page 8 might refresh your
10 recollection.

11 A I haven't read this word for word but I've
12 scanned through it.

13 Q Okay. So is it correct that you testified
14 in ICC Docket No. 00-0340 for Illinois-American Water
15 Company?

16 A Yes, sir.

17 Q All right. And, Mr. Moul, looking at that
18 same document, would you agree that Mr. McNally also
19 testified in that proceeding representing Staff?

20 A Yes, according to the Commission Order he
21 and Mr. Gorman were involved in that case along with
22 me.

1 Q Okay. If I could direct your attention to
2 your rebuttal testimony. Let's see -- pages 6
3 through 7.

4 A I have it.

5 Q Okay. At Pages 6 to 7 there in your
6 rebuttal testimonies, you discuss an update to your
7 analysis and you note the results of that are
8 contained in your Exhibit 19.02; correct?

9 A Yes, sir.

10 Q And on that Exhibit 19.02 you present the
11 models that you used under inputs; is that correct?

12 A Correct.

13 Q Keeping that reference but also looking at
14 your direct testimony on Page 38, Lines 835 to 837 --

15 A Hang on a second. 835. Got it.

16 Q 835 to 837, it's on Page 38 of your direct
17 testimony there. You discuss your initial CAPM
18 analysis and you refer back to Page 32 of that
19 document where you presented Blue Chip Financial
20 Forecasts for corporate -- big A, small double a,
21 n -- big A, small -- strike that -- big A, small
22 double aa, n, big B, small aa rated bonds and the

1 30-year treasury yields for 2012 through 2016 and
2 2017 through 2021.

3 Do you see that?

4 A Yes, sir.

5 Q Okay. Did you update that portion of your
6 analysis in your surrebuttal testimony?

7 A I don't know. I'd have to look.

8 Q Take your time.

9 A I am thinking that I did not.

10 Q So you did --

11 A I updated the information on the prior page
12 but not that one.

13 Q Okay. But that portion of your testimony,
14 you didn't update the analysis?

15 A Well, obviously I was aware of the later
16 information but I didn't submit it in the exhibits,
17 no.

18 Q Would you agree with me that treasury bond
19 yields have fallen since the time of your rebuttal
20 update of June 30th, 2011, for NS-PGL 19.02?

21 MR. JACKSON: I'm going to object at this point
22 on the base of your Honors' prior ruling that we were

1 not to be updating prior testimony and exhibits
2 unless it had already been in the record.

3 MR. FEELEY: I didn't ask him to update it. I
4 said, Did he update it?

5 MR. JACKSON: And he said he didn't update it.

6 MR. FEELEY: I'm asking him a question --

7 JUDGE HILLIARD: We're getting into this thing
8 we're you're talking to each other. Talk to the
9 Bench. Don't talk to each other.

10 Your objection is noted. It's
11 overruled. The situation is different with a report
12 that's dated last Friday than something that's over a
13 period of months --

14 Since February, is that the point in
15 time?

16 MR. FEELEY: No, since his rebuttal update of
17 June 30th, 2011.

18 JUDGE HILLIARD: Well, still -- there's a
19 period of time that's much more reasonable.

20 BY MR. FEELEY:

21 Q So I'll ask you the question again.

22 Would you agree that treasury bond

1 yields have fallen since the time of your rebuttal
2 update of June 30th, 201 for NS-PGL 19.02?

3 A I would agree, yes, with some of the --

4 Q Thank you.

5 A -- yeah -- some of the yields on some of
6 the obligations, I do.

7 MR. FEELEY: If I can approach the witness?

8 JUDGE HILLIARD: Please do.

9 (Whereupon, Staff
10 Cross Exhibit No. 5
11 was marked for
12 identification.)

13 BY MR. FEELEY:

14 Q Mr. Moul, I've handed to you what I've
15 asked the court reporter to mark as ICC Staff Cross
16 Exhibit No. 5, which is a compilation of weekly
17 Federal Reserve bulletins from July 5th, 2011,
18 through August 29th -- or through release date August
19 29th, 2011.

20 Do you have that in front of you?

21 A Yes, sir.

22 Q Do you see in ICC Staff Cross Exhibit No. 5

1 the 30-year U.S. Treasury rate for June 30th, 2011?

2 It's Page 2 under Treasury constant maturities.

3 MR. JACKSON: I apologize, but I need to object
4 as well.

5 These are data beginning July 5th,
6 2011, through August 29th 2011. Anything up to
7 August 15th could and should have been covered by
8 Mr. McNally's rebuttal testimony. I don't know where
9 the cutoff is as to when is too late. But this is
10 clearly updating material that's already in the
11 record, and on that basis I object.

12 JUDGE HILLIARD: I don't know that he's
13 updating anything. He's asking him a question about
14 a document that extends up until a couple of days
15 ago. Why don't we wait and see what the question is
16 before we decide whether or not it's unfair
17 or whatever.

18 MR. JACKSON: Yeah, I just didn't want to have
19 my objection waived by having the information come
20 into the record.

21 JUDGE HILLIARD: Sure.

22 MR. JACKSON: Very good.

1 JUDGE HILLIARD: Go ahead, Mr. Feeley.

2 BY MR. FEELEY:

3 Q Mr. Moul, do you see the 30-year

4 Treasury -- U.S. Treasury rate for June 30th, 2011,

5 and would you agree that it was at 4.38 percent?

6 A I'm trying to line up the columns from

7 Page 1 to 2.

8 4.38?

9 Q 4.38. Yes.

10 A Yes, I agree with that.

11 Q Okay. Now, if you'd look to the next

12 release date of August 8th, 2011.

13 Okay. For the release of August 8th,

14 would you agree that for every single day it was less

15 than 4.38 percent?

16 JUDGE HILLIARD: For every single day from

17 when?

18 BY MR. FEELEY:

19 Q Well, okay, Mr. Moul if you look at all the

20 releases, the August 8th release, the August 15th

21 release, the August 22nd release and the August 29th

22 release, the rates cited for every single day in

1 August was less than 4.38 percent; correct?

2 A I agree with that.

3 Q Would you also agree that the rate was
4 below 4 percent for every single day in August except
5 for August 1st which was just over that at
6 4.07 percent?

7 A I agree with that.

8 Q And if you look at the week ending rates,
9 would you agree that they show a trend to be -- a
10 trend to be clearly downward with the week ending
11 July 1st being 4.36 percent; the week ending
12 August 5th, being 3.88 percent; the week ending
13 August 12th being 3.66 percent; and the week ending
14 August 19th being 3.5 percent; and finally the week
15 ending August 26th being 3.53 percent?

16 A What was the last number again, please?

17 Q For the week ending August 26th, 3.53
18 percent?

19 A Yes, sir, I agree with that.

20 Q Okay.

21 MR. FEELEY: Your Honors, at this time Staff
22 would move to admit into evidence ICC Staff Exhibit

1 No. 5.

2 JUDGE HILLIARD: Which one is 5, John?

3 The interest rate document?

4 MR. FEELEY: Yes, it's -- at the top it says
5 Board of Governors The Federal Reserve System, and
6 they're releases on --

7 JUDGE HILLIARD: Okay. I got it.

8 Objections?

9 MR. JACKSON: I'm going to object to the
10 introduction of the document and move to strike the
11 questions and answers on it on the grounds that up --
12 at least up to August 15th this is information that
13 could have and should have been included in
14 Mr. McNally's rebuttal.

15 Any information thereafter constitutes
16 updating of prior information in the record, new
17 information that was not filed in accordance with the
18 prefiled schedule. And also on the base of your
19 Honors' earlier ruling prohibiting Mr. Fetter from
20 updating his S&P material.

21 MR. FEELEY: Can I respond?

22 JUDGE HILLIARD: Yes.

1 MR. FEELEY: I think the objection from this
2 morning was to a witness updating his analysis and
3 parties not having an opportunity to respond to that,
4 that's what that witness this morning was doing. I'm
5 not doing that.

6 JUDGE HILLIARD: Why are you doing it?

7 MR. FEELEY: I'm showing -- I'm not -- I'm
8 showing that since the time that this witness filed
9 his testimony that factors that he looked at have
10 changed.

11 JUDGE HILLIARD: All right. The objection is
12 noted for the record. Overruled.

13 And Staff Cross Exhibit 5 is admitted
14 into the record.

15 (Whereupon, Staff
16 Cross Exhibit No. 5
17 was admitted into
18 evidence.)

19 BY MR. FEELEY:

20 Q All right. Mr. Moul, is it correct that
21 you use Zacks growth rates for your DCF analysis?

22 A Yes, that was one of the inputs I used. I

1 used a variety of inputs but that was one.

2 Q Okay. But you did not use Zacks betas for
3 your CAPM; is that correct?

4 A No, sir.

5 Q Pardon?

6 A No, sir.

7 Q Did you use Zacks betas for your CAPM?

8 A No, sir.

9 Q All right. Do you have copies of your work
10 papers here? If you don't, I have them.

11 A I might have electronic copies on my
12 computer.

13 Q Mr. Moul, I've handed to you what I
14 represent is Pages 17 through 32 of your rebuttal
15 work papers.

16 Do those look like your rebuttal work
17 papers?

18 A Yes, sir.

19 Q Okay. And those are for the companies in
20 the gas group; correct?

21 A Yes, sir.

22 Q Okay. For AGL Resources, what is its beta

1 according to your work papers there?

2 A According to Zacks publication, the beta is

3 0.46.

4 Q For the next company, Atmos Energy Corp.,

5 what is its beta?

6 A 0.53.

7 Q For the next company the Laclede Group

8 Incorporated, what's its beta?

9 A 0.08.

10 Q For the next company, New Jersey Resource,

11 what is its beta?

12 A 0.19.

13 Q All right. And for the next company,

14 Northwest Natural Gas Company, what is its beta?

15 A 0.31.

16 Q For the next company, Piedmont Natural Gas

17 Incorporated, what is its beta?

18 A 0.26.

19 Q For the next company, South Jersey

20 Industries Incorporated, what is it its beta?

21 A 0.30.

22 JUDGE HILLIARD: How many of these are we going

1 to do?

2 MR. FEELEY: We got one more.

3 BY MR. FEELEY:

4 Q For the final company, WGL Holdings

5 Incorporate, what is its beta?

6 A 0.25.

7 Q Do you know if Morning Star publishes

8 betas?

9 A I'd have to go back and check. I think

10 they do, but I'd need check on that.

11 Q It is correct that your source for the

12 IBES, slash, first call growth rates are the Yahoo

13 Finance Pages included in your work papers?

14 A Yes, sir.

15 Q And Yahoo Finance also publishes betas;

16 correct?

17 A Yes, sir.

18 Q But you don't use Yahoo Finance beta for

19 your CAPM; correct?

20 A No.

21 Q If I could direct your attention to your

22 Page 3 of NS-PGL 19.09.

1 JUDGE HILLIARD: Page 3?

2 THE WITNESS: I have that.

3 BY MR. FEELEY:

4 Q Yeah. Page 3 of NS-PGL 19.09.

5 A Oh, 09. I'm sorry. I'm not with you. I

6 have that.

7 Which page.

8 Q Page 3.

9 A I have that.

10 Q Okay. Looking at that Page 3 of 19.09 you

11 use the July 1st, 2011, Blue Chip Financial Forecast

12 in your rebuttal update of your risk premium

13 analysis; is that correct?

14 A Yes, sir.

15 MR. FEELEY: If I can approach the witness.

16 (Whereupon, Staff

17 Cross Exhibit No. 6

18 was marked for

19 identification.)

20 BY MR. FEELEY:

21 Q Mr. Moul, I've handed to you what I've

22 asked the court reporter to mark as ICC Staff Cross

1 Exhibit No. 6. And it's the August 1st, 2011 Blue
2 Chip Financial Forecasts.

3 Do you agree that's what that ICC
4 Staff Cross Exhibit No. 6 is?

5 A I do.

6 MR. FEELEY: At this time I'd move to admit
7 into evidence ICC Staff Cross Exhibit No. 6, the Blue
8 Chip Financial Forecast, August 1st, 2011.

9 MR. JACKSON: Objection, your Honor, now
10 Mr. Moul is being required -- or being asked to
11 update directly information in his testimony.
12 There's no -- absolutely no distinction between Staff
13 effective requiring Mr. Moul to update his
14 information and us trying to have our witness update
15 his own information.

16 JUDGE HILLIARD: I don't think they've asked
17 him to update anything. They've asked him to
18 identify this document which is a document that the
19 relied upon or a different -- addition of the same
20 document he relied upon in his testimony. He hasn't
21 made any comments.

22 MR. JACKSON: No. They've offered into

1 evidence the August 1st version of a July 1st
2 document he relied on in his testimony.

3 If I were offering the same document,
4 I would be accused of having my witness updating his
5 own information.

6 JUDGE HILLIARD: No. It isn't updating the
7 documents that's the problem. The problem is if you
8 update with a document that's -- was released in so
9 short a time period that the other side hasn't had
10 time to review it, that's inappropriate.

11 This is an August 1st document. This
12 man is an expert in his field. If he's not familiar
13 with this document, if he hasn't seen this document,
14 that's something you can establish on redirect.

15 Your objection's overruled.

16 BY MR. FEELEY:

17 Q Mr. Moul, I have just a few more questions
18 for you.

19 I direct your attention to your direct
20 testimony Lines 652 to 655.

21 A 650?

22 Q I'm sorry. Your Exhibit 3.0, 652 through

1 655?

2 A I have that.

3 Q In your testimony there you're discussing

4 bond yields; is that correct?

5 A I mention them, sure.

6 Q Well, you use them in your risk premium

7 analysis; correct?

8 A Yes, it was one of the building blocks of

9 the risk premium analysis, correct. I agree with

10 that.

11 Q And that's what you further discuss at

12 Line 661 through 662; correct?

13 A Yes, sir.

14 MR. FEELEY: If I can approach the witness.

15 JUDGE HILLIARD: If I haven't said so already,

16 Staff Cross Exhibit 6 is admitted into the record.

17 (Whereupon, Staff Cross Exhibit

18 No. 6 was admitted into

19 evidence.)

20 (Whereupon Staff Cross Exhibit

21 No. 7 was marked for

22 identification.)

1 BY MR. FEELEY:

2 Q Mr. Moul, I've asked the court reporter to
3 mark for identification as ICC Staff Cross Exhibit
4 No.7, which are the Moody bond yields as of
5 August 29, 2011.

6 Do you have that in front of you?

7 A Yes, I have that.

8 Q And you used Moody bond yields in your risk
9 premium analysis; correct?

10 A Yes, sir.

11 MR. FEELEY: Your Honors, at this time Staff
12 would moved to admit into evidence ICC Staff Cross
13 Exhibit No. 7, the Moody bond yields as of August
14 29th, 2011.

15 MR. JACKSON: Objection.

16 JUDGE HILLIARD: It's the same objection;
17 right?

18 MR. JACKSON: Well, but this one's August 29th,
19 clearly too late. If August 26th was too late the
20 29th ought to be too late.

21 JUDGE HILLIARD: I think there's a substantive
22 difference between trying to update your testimony

1 and being cross-examined about documents you relied
2 upon in forming testimony about trends in the
3 marketplace.

4 So your objection is noted and
5 overruled, and the exhibit will be admitted into the
6 record.

7 (Whereupon, Staff Cross
8 Exhibit No. 7 was admitted
9 into evidence.)

10 MR. JACKSON: Okay. But may I raise one point?

11 JUDGE HILLIARD: Sure.

12 MR. JACKSON: I believe your characterization
13 of the S&P Report we tried to get in earlier was not
14 correct. It was just like this document. It's an
15 updated version.

16 JUDGE HILLIARD: The differences is between
17 cross-examination and direct examination. That's the
18 difference.

19 MR. JACKSON: Okay.

20 JUDGE HILLIARD: Go ahead.

21 MR. FEELEY: I'm sorry. That was admitted into
22 evidence?

1 JUDGE HILLIARD: It was admitted.

2 MR. FEELEY: Thank you, Mr. Moul. That's all I
3 have for you.

4 THE WITNESS: You're welcome.

5 JUDGE HILLIARD: Redirect.

6 MR. JACKSON: May I have a moment?

7 JUDGE HILLIARD: Sure.

8 (Whereupon, a discussion was had
9 off the record.)

10 MR. JACKSON: Okay. I'm ready.

11 JUDGE HILLIARD: Okay. Proceed.

12 MR. JACKSON: Thank you, your Honor.

13 REDIRECT EXAMINATION

14 BY

15 MR. JACKSON:

16 Q Mr. Moul, I want to point your attention to
17 Staff Cross Exhibit 6, the second page. If the
18 Commission were looking for the most up-to-date and
19 relevant information pertaining to the utilities test
20 year, what forecasts of interest rates should they be
21 looking at on this page?

22 A I would be looking at the forecast for 2012

1 and in particular for the fourth quarter of 2001.

2 Q Why is that?

3 A Well, those are the most relevant forecasts
4 that are being made in the Blue Chip publication and
5 it also correspondences with the test year in this
6 proceeding.

7 Q And how do the fourth quarter 2012 interest
8 rates for Corporate A and Corporate B bonds compare
9 to the interest rates you relied on in your analysis
10 dated July 1st, 2011?

11 A There's hardly any difference in the realm
12 of AAA rated corporate bond yields. The more recent
13 August the 1st forecast is showing a 5.6 percent
14 yield as opposed to a 5.7 yield that I used in my
15 rebuttal update. Hardly any change.

16 And for BBB, also known as BAA bonds,
17 the forecast yield is 6.5 percent. Again, very small
18 change from the 6.6 percent that I used in my
19 rebuttal up dates.

20 With the forecasts in the fourth
21 quarter of 2012 even though interest rates have
22 fallen, as we noted earlier in the Treasury market,

1 the forecast for corporate bond yields hasn't been
2 anywhere near that large of a decline.

3 Q And how about for the 30-year Treasury
4 note?

5 A Returning to the Treasuries that we talked
6 about earlier the forecast in the fourth quarter 2012
7 of is 5.0 percent. That's compared to the 5.2 I used
8 in my rebuttal testimony. Down, yes; but not -- not
9 significantly lower.

10 So when you get to the far end of the
11 yield curve, the forecast do not show near the type
12 of decline that we've seen just in the last couple
13 weeks for the Treasury bond yields.

14 Q Mr. Feeley asked you about Yahoo.com betas,
15 do you recall that question?

16 A Yes, sir.

17 Q Could you explain why you don't use the
18 Yahoo.com betas.

19 A Mostly because I don't have a good handle
20 on how they're developed. Unlike the Value Line
21 betas, we don't know whether Yahoo is computing those
22 betas themselves or they're purchasing them from an

1 outside vendor. We don't know if they're adjusted or
2 not, although I suspect they aren't only because of
3 the magnitude of the difference in the betas. We
4 don't know the independent variable that was used in
5 the Value Line -- or in the -- we don't know the
6 independent variable used in the Yahoo betas, where
7 we do know what that is in the Value Line beta. We
8 don't know the measurement interval.

9 There's just such a large number of
10 questions as to how Yahoo went about publishing their
11 beta and whether they're even their own. But on the
12 Value Line side, we do know how those are done.

13 Q I want to go back now to Mr. Reddick's
14 discussion with you and there was some discussion
15 about bull and bear markets and whether -- it's an
16 objective fact as to whether or not such a market
17 exists.

18 Would you agree that whether a bull or
19 bear market exists could be a matter of opinion?

20 A Certainly when it's occurring it's a matter
21 of opinion. With hindsight, looking back, if we were
22 in 2012 or 13 looking back at what the market

1 conditions are today, we could pretty much tell
2 whether the falloff in stock prices was a bull market
3 correction or the beginning of a bear market. We'll
4 eventually know at some point out in the future but
5 today it is a matter of opinion.

6 Q Now, with respect to today's investor
7 expectations would you agree that investors could
8 have different expectations -- or I'm sorry --
9 different opinions about whether we are currently in
10 a bull or bear market?

11 A Sure.

12 Q And in your work developing cost of equity
13 recommendations for the Commission, are you looking
14 at the expectations of any individual investor in
15 particular or not or what?

16 A No, I'm looking at a market consensus.
17 That's why when we look at these forecasts we get
18 from analysts they're typically a consensus.

19 Q Mr. Reddick asked you some questions
20 regarding the analyst's use of judgment in coming up
21 with a cost of equity recommendation.

22 Would you agree that the analyst must

1 use judgment in determining which models to use?

2 A Absolutely.

3 Q Would you agree that the analyst has to use

4 judgment in which version of individual models to

5 use?

6 A I agree with that.

7 Q Would you agree that the analyst has to use

8 judgment in determining the data inputs to the

9 models?

10 A Yes.

11 Q The analyst can select from various sources

12 of different sources of market data; correct?

13 A Yes.

14 Q And do you agree that the analyst needs to

15 use judgment in interpreting the results of the

16 models?

17 A Absolutely.

18 Q Mr. McNally and Mr. Thomas use judgment in

19 making each of those decisions in employment of their

20 models don't, they?

21 A Certainly with regard to the inputs, yes,

22 and the forms of the model, correct.

1 Q And which models to use?

2 A Sure. For instance on DCF whether they use
3 a constant or a non-constant form of the model,
4 that's a basic judgement.

5 Q Whether they use a risks premium model or
6 not?

7 A Correct.

8 Q They use judgment interpreting the results
9 of the models as well, don't they?

10 A Not as much as I would like to see them
11 use.

12 Q Mr. Reddick asked you several questions
13 regarding Exhibit 19.01 which was the collection of
14 other returns -- or return awards for the utilities
15 in Illinois and other states.

16 Was that exhibit put together as a
17 proxy group on which a ROE recommendation should be
18 based in this case?

19 A Oh, no, it was -- the data was assembled
20 for the sole purpose of gauging the overall
21 parameters of the types of returns that regulatory
22 agencies are giving public utilities.

1 Q For that purpose, is it necessary to know
2 all the details behind each and every one of the
3 return awards?

4 A No, not for that purpose.

5 MR. JACKSON: That's all I have. Thank you.

6 JUDGE HILLIARD: Recross?

7 MR. REDDICK: One question.

8 RECROSS-EXAMINATION

9 BY

10 MR. REDDICK:

11 Q In your response to one of Mr. Jackson's
12 questions you mentioned reliance on the market
13 consensus as opposed to individual investors.

14 Is the market's consensus you referred
15 to documents publish by equity market analysts?

16 A Sure. We've talked about some of them,
17 Ibis, Yahoo Finance, Zacks, those types of --

18 Q Thank you.

19 A -- and that's what they are. They're
20 surveys and then it's a consensus of the survey.

21 MR. REDDICK: Thank you.

22 JUDGE HILLIARD: Re-redirect?

1 MR. JACKSON: No.

2 JUDGE HILLIARD: Thank you, sir.

3 THE WITNESS: You're welcome.

4 JUDGE HILLIARD: Let's take a little break.

5 (Whereupon, a recess was taken.)

6 JUDGE HILLIARD: Okay. I have a little
7 announcement to make.

8 During the break I was pondering my
9 earlier rulings and I decided I'm going to reverse
10 myself on Cross Exhibit 7, that the time period --
11 the day of the document is the 29th. And the date of
12 the document that I came up this morning was
13 approximately that time period. And I think to be
14 fair to both sides, the questions and the document
15 regarding Cross Exhibit 7 will be stricken from the
16 record.

17 MR. JACKSON: Before we get started, I don't
18 know if this needs to be on the record or not, but I
19 just wanted to let people know that, with your
20 indulgence, myself and Mr. Eidukas have split the
21 cross. Our workload did not allow me to -- at least
22 to cover -- he's just asking questions regarding the

1 principal components analysis part of the rebuttal.

2 JUDGE HILLIARD: All right. So your area's

3 going to be what?

4 MR. JACKSON: My area would be everything else.

5 JUDGE HILLIARD: You're doing the principal

6 components analysis?

7 MR. EIDUKAS: Yes.

8 JUDGE HILLIARD: And who's going to go first?

9 MR. JACKSON: I will go first. And I will have

10 no questions on the principal components analysis.

11 No overlap.

12 JUDGE HILLIARD: We're going to follow the rule

13 that within each area only one lawyer asks questions.

14 You don't get to tag team a witness. All right.

15 (Witness sworn.)

16 MR. FEELEY: At this time staff would call it's

17 next witness, Mr. Michael McNally.

18

19

20

21

22

1 MICHAEL McNALLY,
2 called as a witness herein, having been first duly
3 sworn, was examined and testified as follows:
4 EXAMINATION
5 BY
6 MR. FEELEY:
7 Q Could you please state your name for the
8 record.
9 A Michael McNally, M-c-N-a-l-l-y.
10 Q And, Mr. McNally, who are you employed by?
11 A The Illinois Commerce Commission.
12 Q Mr. McNally, do you have in front of you a
13 document which has been marked for identification as
14 ICC Staff Exhibit 5.0 corrected, direct testimony of
15 Michael McNally, 38 pages of narrative text and
16 attached schedules 5.1 through 5.55?
17 A Yes.
18 Q Mr. McNally, was ICC Staff Exhibit 5.0
19 corrected and attached schedules prepared by you or
20 under your direction, supervision and control?
21 A Yes.
22 Q Do you have additions, deletions or

1 modifications to make to that -- your testimony or
2 schedules?

3 A No.

4 Q Mr. McNally, do you have in front of you
5 what's been marked for identification as ICC Staff
6 Exhibit 14.0, rebuttal testimony of Michael McNally
7 and attached Schedules 14.1 through 14.4?

8 A Yes.

9 Q Mr. McNally, was ICC Staff Exhibit 14.0,
10 the narrative testimony and the attached schedules,
11 prepared by you or under your direction, supervision
12 and control?

13 A Yes.

14 Q Do you have any additions, deletions or
15 modifications to make to ICC Staff Exhibit 14.0 or
16 the attached schedules?

17 A I have a handful.

18 The first one's beginning on Page 13.
19 The reference in Footnote 25 should be to NS-PGL
20 Exhibit 19.0, Page 15.

21 Q Which footnote was that?

22 A 25.

1 JUDGE HILLIARD: 19.0.

2 THE WITNESS: Instead the PR-2.0, Page 16, it
3 should be 19.0, Page 15.

4 JUDGE HILLIARD: Okay.

5 BY MR. FEELEY:

6 Q Any other ones?

7 A Yes.

8 On Page 16, on Line 348, the word,
9 principal should be spelled p-r-i-n-c-i-p-a-l. And
10 the same goes in Footnote 32 for the second word.

11 On Page 21, the Q and A beginning on
12 Line 440 should reference -- the second line should
13 say, Associated with a 55.06 percent common equity
14 ratio than there is with a 66.37 percent common
15 equity ration, rather than 69.37.

16 And then again on Line 445, that 69.37
17 should be corrected to say 66.37. And I would add
18 the word "concurrent" before that.

19 MR. JACKSON: I'm sorry where did the
20 "concurrent" go?

21 THE WITNESS: Between "the" and the number
22 "66.37."

1 MR. JACKSON: Concurrent. Okay.

2 THE WITNESS: And then finally on the same page
3 Footnote 45, the entire reference should be stricken
4 and replaced with NS-PGL Exhibit 19.06, Page 1.

5 MR. FEELEY: Your Honors, I would note that
6 those Exhibits 5.0, and the Schedules 5.1 to 5.5 were
7 filed on e-Docket on July 19th, 2011 and rebuttal
8 with the schedules filed on August 15th 2011.

9 BY MR. FEELEY:

10 Q Mr. McNally do you intend your testimony
11 contained in ICC Staff Exhibit 5.0 and attached
12 Schedules in 14.0, your rebuttal testimony and
13 attached schedules to be your sworn testimony in this
14 proceeding?

15 A Yes.

16 MR. FEELEY: At this time Staff would move to
17 admit into evidence ICC Staff Exhibit 5.0, corrected,
18 and the attached schedules; and ICC Staff
19 Exhibit 14.0 and the attached schedules, that being
20 the rebuttal testimony.

21 MR. JACKSON: No objection.

22 JUDGE HILLIARD: Is there surrebuttal

1 testimony?

2 MR. FEELEY: Rebuttal I said.

3 JUDGE HILLIARD: I know, but are you going to

4 admit surrebuttal testimony? You didn't do any --

5 I'm sorry.

6 MR. FEELEY: Yeah.

7 JUDGE HILLIARD: Okay. Objections?

8 MR. JACKSON: No objection.

9 JUDGE HILLIARD: Exhibits -- Staff Exhibits 5.0

10 with attachments and 14.0 with attachments or

11 schedules are admitted into the record.

12 (Whereupon, Staff Exhibit Nos.

13 5.0 and attachments and 14.0

14 and attachments were admitted

15 into evidence.)

16 MR. FEELEY: Mr. McNally is available for

17 cross-examination.

18 JUDGE HILLIARD: Who's going to go first?

19 MR. JACKSON: I am, your Honor.

20

21

22

1 CROSS-EXAMINATION

2 BY

3 MR. JACKSON:

4 Q Go good afternoon, Mr. McNally. I'm Brad
5 Jackson on behalf of the Utilities in proceeding.

6 Mr. McNally, do you agree that
7 estimating a firm's cost of equity involves a mix of
8 art and science?

9 A Yes.

10 Q Do you agree that each of the models that
11 analysts use to calculate the cost of equity require
12 the exercise of some subjectivity by the analyst?

13 A Yes.

14 Q Do you agree generally with my discussion
15 with Mr. Moul that you need to choose the model to
16 use, what version of the model to use, some choice
17 among data inputs and weighing of the results?

18 A There is judgment involved in those steps,
19 yes.

20 Q Yes. Thank you.

21 Would you also agree that each of the
22 models that analysts use have their own shortcomings

1 that can result in misstating a firm's cost of
2 equity?

3 A Yes.

4 Q So I take it you would agree that
5 determining a firm's ROE or setting an authorized ROE
6 for a utility isn't as simple as running a model and
7 getting a result?

8 A No. I do agree.

9 Q Thank you.

10 Now, when you estimate cost of equity
11 in these cases you typically employ the DCF and CAPM
12 models; correct?

13 A Yes.

14 Q Do you agree with Mr. Moul that the DCF
15 suffers from a degree of circularity to the extent it
16 relies on investor expectations in its inputs?

17 A Can you clarify how that -- where the
18 circularity lies?

19 Q To the extent that data that is relied on
20 for the DCF are measures of investor expectations,
21 does that create any sort of circularity in the
22 model?

1 A No, we use that -- I mean, the fact that
2 they reflect data -- I mean, investor expectations is
3 exactly what we were trying to measure.

4 Q Maybe I misunderstand.

5 Have you -- are you aware of
6 criticisms of the DCF model that there is circularity
7 to it?

8 A I have heard that argument in previous
9 cases. I can't remember exactly what the specific
10 argument was, but I do know people have made that
11 argument.

12 Q Is that an argument you subscribe to or
13 agree with?

14 A No.

15 Q Okay. Do you agree that the DCF model does
16 not adequately recognize capital gains yields arising
17 from stock price growth?

18 A Can you repeat that question.

19 Q Sure.

20 Do you agree that the DCF model does
21 not adequately recognize capital gains yields arising
22 from stock price growth?

1 A No.

2 Q Do you remember agree that one of the
3 limitations of the CAPM model is that considers only
4 systemic risk?

5 A I don't believe that to be a limitation.

6 Q I'm sorry, I didn't...

7 A I don't believe that to be a limitation.

8 Q It does not consider risks specific to an
9 industry or firm; correct?

10 A It does to the extent that they are -- that
11 that firm's -- variability of that firm's price
12 varies with the market.

13 Q But otherwise, the CAPM model does not
14 consider risks that are specific to a firm or an
15 industry; is that correct?

16 A No, the intention is to have -- it assumes
17 a well-diversified portfolio and does not award --
18 reward investors for having poorly a diversified
19 portfolio. That -- in which the specific company's
20 specific risk can be diversified -- can be minimized
21 through diversification.

22 Q Would you agree that the assumption that

1 all investors have well-diversified portfolios is not
2 necessarily true in the real world?

3 A But we don't reward investors who invest
4 poorly -- the market doesn't. So, yes, I -- no, I
5 agree that not every investor has a well-diversified
6 portfolio -- or at least I don't doubt that one bit.

7 Q Now, regulator risk is an unsystemic risk;
8 correct?

9 A Yes, that would be -- specific to certain
10 companies in -- under a specific jurisdiction.

11 Q I guess to rephrase I could say public
12 utility regulatory risk would be a risk -- unsystemic
13 risk specific to public utilities; is that fair?

14 A I'm sorry. Can you repeat that.

15 Q Public utility regulation by the ICC and
16 other commissions would be an unsystemic risk
17 associated with public utilities as an --

18 A Yes, you're saying they're not -- they're
19 not systematic relative to -- you know, from Illinois
20 to Iowa to California.

21 JUDGE HILLIARD: Mr. McNally, can I ask you
22 to move your mike down a little bit, your audibility.

1 BY MR. JACKSON:

2 Q Do you agree that for portfolios of betas
3 less than 1.0 the CAPM understates the return?

4 A I don't believe financial studies have
5 demonstrated that to be -- that to be true.

6 Q And I take it then you don't -- you would
7 not agree then either that for portfolios of betas
8 greater than 1.0 that CAPM overstates the return?

9 A Not necessarily.

10 Q Is it a potential limitation of the CAPM
11 that it could have this relationship with -- between
12 the beta and the end result? Is that a potential
13 limitation or problem?

14 A If it were true -- people have studied and
15 the results have been inconclusive. So, yes, if it
16 were true, but we don't -- that's the whole point is
17 we don't know it to be true.

18 Q Okay. Do you agree that the utilities
19 compete for capital with other utilities nationally
20 and even other firms nationally?

21 A Certainly.

22 Q I'm want to ask you a couple questions

1 about your criticism of Mr. Moul and his use of
2 historical data in his analysis. I just want to make
3 sure we understand each other with respect to that
4 use.

5 Is it correct that with respect to the
6 growth component of his DCF analysis, he reviewed
7 historical and forecast earnings per share growth and
8 then picked a point estimate based on his review of
9 that data?

10 A I'd have to double check, but I think
11 that's correct.

12 Q Would you like time to check or you just
13 accept that subject to check?

14 JUDGE HILLIARD: Why don't we do it subject to
15 check?

16 THE WITNESS: Okay. Subject to check.

17 BY MR. JACKSON:

18 Q So it wouldn't be exactly correct to say
19 that he simply took a historical earnings per growth
20 rate and plugged it into his model; correct?

21 A He used forward-looking growth rates, so,
22 yeah -- no. No, he did not historical data for his

1 growth, as I have used the word.

2 Q But when you say in your testimony that
3 Mr. Moul should not have used historical data in his
4 analysis, is there any instance that you can point to
5 where he literally took a point of data that's
6 historical and plugged it into the model versus a
7 consideration of historical data among other data to
8 pick a point estimate?

9 A Yes, in fact, that's the criticism -- the
10 only criticism I have as far as historical data goes
11 was with regard to -- let me see if I can find it
12 here -- equity risk premium estimated in his risk
13 premium model.

14 Q And there he averaged data for the S&P
15 utilities over two historical periods and then
16 adjusted the result, did he not?

17 A You are referring to the 6.23 percent that
18 he adjusted downwards to 5.50 percent?

19 Q I don't have the exact percentages -- or
20 rates at my fingertips.

21 But subject to check, yes.

22 A Yes, he adjusted that for the difference in

1 risk between the sample from which he -- from the
2 index from which he gathered -- he estimated 6.23 for
3 application to the gas group.

4 Q Are there any other points in Mr. Moul's
5 analysis where this criticism of use of historical
6 data applies?

7 A I'm not certain. As I said in my direct
8 testimony, the only one I directly addressed was his
9 risk premium model, as I recall at least. I'm pretty
10 certain that's true.

11 Q I would like you to take a look at Page 10
12 of your rebuttal Exhibit 14.0.

13 A All right.

14 Q All right. And specifically note Footnote
15 21. And there you're describing the week of
16 August 8th, 2011, where you had -- I think as we all
17 know -- the stock market was rising and falling
18 dramatically day by day; correct?

19 A Yes, that's what I depict there in the
20 first sentence.

21 Q And you state that the high degree of daily
22 volatility indicates the market was not at

1 equilibrium that week; correct?

2 A Yes.

3 Q Is your point there that when there is a
4 high degree of daily volatility in the market, that
5 if one were to rely on data from those days, the
6 model results might not be reliable?

7 A I'm not sure if reliable is the correct
8 word. But as I indicated, I would not recommend
9 using that date because the extreme volatility --
10 every day there's some volatility. But in that
11 particular week it was particularly volatile. So I
12 recommended against the use of that week.

13 Q What I guess I'm trying to get at is, so
14 what's the problem? Why would you not have anyone --
15 have the Commission rely on data from those days due
16 to the volatility? What problem is there with model
17 results based on that data?

18 A Finances -- well, as you asked earlier,
19 finances are art, part science. It's a social
20 science to a degree. Part of finance is behavioral
21 and people react and overreact and from day to day in
22 times of high volatility that frequently is the case

1 and there's typical -- typically you can have a swing
2 and then a correction.

3 Q And so if I put my reliability word aside,
4 if one based their models on data during this time
5 period, would your concern be that the models would
6 produce an inaccurate result? Or use your own term.
7 I'm trying to get at --

8 A Inaccurate might be a -- I think would
9 probably be a -- it might be a better word.

10 Q Okay. Close?

11 A Yeah.

12 (Whereupon, there was a change
13 of reporters)

14

15 (Change of reporter.)

16 Q Your direct testimony, Page 26.

17 At 507 and 508, you state that in the
18 Company's previous rate case, market conditions were
19 much worse and for that, you point to the VIX, V-I-X,
20 Index, correct?

21 A Yes.

22 Q And the VIX was up around 40 in December

1 2008, correct?

2 JUDGE HILLIARD: If you're going to use an
3 acronym and it's the first time, can you explain it
4 for us.

5 MR. JACKSON: I'm sorry. Yes. VIX, V-I-X, is
6 an acronym for the Chicago Board Options Exchange
7 Volatility Index.

8 JUDGE HILLIARD: Thank you.

9 BY MR. JACKSON:

10 Q Is that right, that in December 2008 time
11 frame, the VIX was at about 40?

12 A Yes.

13 Q Would you accept, subject to check, that
14 the VIX has averaged almost 40 since the S&P
15 downgraded the U.S. credit rating?

16 A What date was that?

17 Q August 5th.

18 A Boy.

19 JUDGE HILLIARD: Have you got a document to
20 show him?

21 THE WITNESS: That would be very helpful.

22 BY MR. JACKSON:

1 Q Do you know?

2 A I don't know.

3 Q Okay.

4 A I haven't looked that up.

5 Q If I could then direct you to your -- back
6 to your rebuttal, Page 8.

7 A Okay.

8 Q At the top of the page, you state that you
9 use a sample to minimize the effects of any potential
10 inefficiencies in stock prices, correct?

11 A Yes.

12 Q And you also state that estimates for a
13 sample as a whole are subject to less measurement
14 error than the individual company estimates, right?

15 A Yes.

16 Q Now, how does -- tell me how the use of the
17 sample can make the inefficiencies in individual
18 stock prices go away so that there's less measurement
19 error.

20 A To the extent you pick an unbiased sample,
21 misstatement of the estimate for each -- any single
22 company is just as likely to be above or below the

1 true mean.

2 Q So in effect, the inefficiencies on either
3 side cancel each other out; is that --

4 A It's sort of like a diversification of a
5 portfolio, yes, that's the assumption.

6 Q Did you perform any analysis with respect
7 to the specific sample to determine whether that was
8 the case here?

9 A You know, I don't recall. I have in the
10 past looked at individual results and the standard
11 deviation of those results from the mean. And I
12 typically do that, but I can't say whether I did that
13 in this case or not.

14 Q And then your rebuttal on Page 21, the Q
15 and A starting at Line 440, are you saying that if
16 you have a group of companies, a portfolio, and their
17 cost of equity was established based on a market
18 equity ratio of 66 percent, that there'd be no
19 difference in the cost of equity if it was measured
20 based on a 55 percent book value ratio?

21 A No, that is absolutely not what I'm saying.

22 Q So the cost of equity would vary depending

1 on the equity ratio, correct?

2 A If a Company's equity ratio was -- if you
3 take the same com- -- the same sample, all else
4 equal, and the only difference is the equity ratio is
5 55 percent, it will have a higher degree of financial
6 risk than if that same company had a 66 percent
7 equity ratio; but a company cannot be riskier than
8 itself at any point at time. So you cannot have a 66
9 and a 55 measured on the same scale.

10 Q Gotcha.

11 MR. JACKSON: That's all I have.

12 JUDGE HILLIARD: That's promising.

13 CROSS-EXAMINATION

14 BY

15 MR. EIDUKAS:

16 Q Good afternoon, Mr. McNally. My name's Ted
17 Eidukas. I will be asking you about the principal
18 component analysis portion of your rebuttal.

19 A Alrighty.

20 Q But actually I'd first like to start -- I
21 want to make sure you have it in front of you to
22 refer to, is copies of Mr. Moul's direct and his

1 rebuttal. And if not, I can get copies of those for
2 you.

3 A I have those.

4 Are those the only company witnesses
5 you're going to reference?

6 Q Those are the only company witnesses, yes.

7 A Okay.

8 Q And I assume you have your testimony, as
9 well, that we'll get to in a short --

10 A Yes.

11 Q -- while.

12 Okay. Just a preliminary question,
13 is -- DO you agree that the method used to determine
14 a firm's cost of equity should reflect both operating
15 and financial risk of the firm?

16 A Yes, I do.

17 Q Now, in Mr. Moul's direct testimony, he
18 performed an analysis called a proxy group analysis
19 to determine a group of companies that would act as A
20 proxy for the operating risk of both North Shore and
21 Peoples Gas.

22 And referring to the Peoples Gas -- to

1 Peoples Gas direct testimony -- that would be on
2 Pages 6 through 13 -- so I would ask you if that is
3 your understanding of what that portion of his
4 testimony does?

5 A That's a term -- his term. I don't believe
6 "proxy group analysis" is an official -- like an
7 established analysis, but that's what he refers to as
8 his -- when he does his analysis of that group --
9 those groups.

10 Q And what he -- and what he called the proxy
11 group that he developed from that testimony -- or
12 from that analysis, he called the Gas Group, correct?

13 A That was -- well, not that he developed
14 from the analysis, but he analyzed the groups he had
15 developed prior -- previously in his testimony. And
16 one of those was the Gas Group, yes.

17 Q Turning to Pages 12 through 13 of
18 Mr. Moul's direct, would it be fair to summarize
19 Lines 250 through 264 as Mr. Moul coming to the
20 conclusion that the Gas Group's overall investment
21 risk is lower than Peoples Gas' and North Shore Gas'
22 investment risk?

1 A He makes the statement that the Gas Group
2 has lower overall investment risk than the Company.

3 Q And, in fact --

4 A Because he says that of -- I'm only looking
5 at PGL.

6 Q Let's look at PGL and I'll confine my
7 statements to PGL testimony. And I will represent to
8 you subject to checking that there is similar
9 testimony in Mr. Moul's direct for North Shore Gas as
10 well --

11 A All right.

12 Q -- subject to check.

13 And then in -- if you look on Page 13,
14 Lines 263 through 264, Mr. Moul, in fact, concludes
15 that the rate of return on common equity that was
16 set -- would be set for Peoples Gas in this case
17 should recognize his conclusion that they have a --
18 that Peoples Gas has a higher risk than the Gas
19 Group, correct?

20 A Yes.

21 Q And if you turn to Page 29 of Mr. Moul's
22 direct, if you look at Lines 2 -- 645 through 648,

1 wouldn't you agree that he relies upon that same
2 conclusion, that the Gas Group has a lower risk than
3 the -- than Peoples -- investors in Peoples Gas to in
4 part conclude -- is one of the reasons why he decided
5 to exclude the results of his DCF analysis?

6 A That is one of the reasons I think
7 elsewhere he states is because DCF is an outlier
8 relative to his other estimates.

9 Q And then if you turn back to Page 6 of
10 Mr. Moul's direct, didn't he also testify at
11 Lines 116 through 118 that if you were to include the
12 results of the DCF -- the DCF analysis in his
13 recommendation, he would still recommend an 11.25
14 percent cost of equity in order to reflect his
15 conclusion that the Gas Group collectively had
16 overall lower investment risk than Peoples Gas?

17 A He states that. I'm a bit confused by it,
18 but he does state that.

19 Q All right. And so when you went to prepare
20 your direct testimony, am I correct that you would
21 have reviewed all of these statements that were in
22 Mr. Moul's direct testimony?

1 A Yes.

2 Q So looking at your direct testimony -- I'm
3 looking at Page 2, Lines 39 through 42, in a section
4 of your testimony called "sample selection" --

5 A Just a second, please.

6 Q Oh, sure. Let me know when you're ready.

7 A My direct, you said?

8 Q Your direct, correct.

9 A Page 2?

10 Okay. Which lines?

11 Q At the bottom it's Lines 39 through 42.

12 A Okay.

13 Q And isn't it correct that there you state
14 that you adopt the same group of gas utility
15 companies that Mr. Moul used to estimate the return
16 on common equity for North Shore and Peoples Gas?

17 A Yes.

18 Q And then you go on to state that you -- you
19 believed that Mr. Moul's sample companies provide
20 reasonable proxies with the operating risk of North
21 Shore and Peoples Gas?

22 A Yes.

1 Q Now, in Mr. Moul's direct in his analysis
2 where he comes to these conclusions you're talking
3 about here, would it be fair to say that he uses
4 certain financial data -- I'm now looking at Line --
5 Pa- -- well -- yeah, Pages -- in Mr. Moul's direct it
6 is 8 through 11.

7 A Yes.

8 Q And if you added up the underlying terms to
9 describe the categories of financial data, there's
10 eight of them.

11 Would you --

12 A That which he compared to the gas company
13 and the -- the companies --

14 Q Correct.

15 A -- PGL and North Shore?

16 Q Yes.

17 A Yes.

18 Q Now, nowhere near the --

19 A Actually, let me correct that. Not all
20 eight of them were financial measures. They were
21 all -- they were financial and operating and total
22 risk measures.

1 Q Okay. But -- okay. Given with that
2 qualification, I'm correct -- isn't it correct that
3 in your direct testimony, you don't anywhere
4 criticize his choice of those eight criteria or
5 categories of information?

6 A I do not comment on them.

7 Q Okay. And you don't also include any
8 comment in your direct that he should've used
9 different categories of financial or operating data
10 for that analysis?

11 A No, I don't.

12 Q Or that he should have used additional
13 categories of financial or operating data for that
14 analysis?

15 A No, I don't.

16 Q And you also don't state in your direct
17 that he should've included utilities other than
18 natural gas and electric power companies to perform
19 that analysis, correct?

20 A Can you restate that, please?

21 Q Sure.

22 In the -- Mr. Moul's analysis of

1 trying to determine proxy companies and those pages
2 we looked at with those eight categories of financial
3 and operating data, you state -- he looked at his Gas
4 Group which included natural gas companies, correct?

5 A His Gas Group includes natural -- his
6 companies are primarily natural gas distribution
7 companies, yes.

8 Q And then he had a group he called a
9 combination group?

10 A Yes.

11 Q And that included -- I believe those
12 also -- am I correct that those also included natural
13 gas companies, but also electric companies as well?

14 A That is true.

15 Q And then he had what he calls the S&P
16 public utilities group, which includes its larger
17 group, but the companies in that group only included
18 natural gas and electric power companies; is that
19 correct?

20 A I don't know that that's all they included.
21 I know they included both natural -- well, they
22 included companies with natural gas -- some degree of

1 natural gas distribution operations -- we don't know
2 how much -- and it also included electric companies,
3 some of which are integrated; but I don't know if
4 there is anything else in there. I --

5 Q I can -- it's Exhibit 3.5 that was attached
6 to his testimony -- his direct testimony.

7 A I can't say with certainty what exact --
8 what all operations each of these companies is
9 involved with. They do appear to be almost all
10 electric and natural gas.

11 Q To your --

12 A To my knowledge they all are electric and
13 natural gas, but I'm not certain.

14 Q So to your knowledge, none of these
15 companies, for example, provide water or sewer
16 services?

17 A No. But, I mean, I know some of -- like,
18 for instance, Nicor has a tropical shipping unit. I
19 mean, I learned -- they very well may be, as Mr. Moul
20 acknowledged they are -- some of them are integrated
21 companies that have subsidiaries that are not in the
22 natural gas or electric delivery op- -- industry.

1 Q But -- so I'll go back to my -- I hope I've
2 set the stage to answer -- go back to -- my original
3 question was, in your direct testimony, you were
4 reviewing -- you were responding to Mr. Moul's direct
5 testimony, you didn't comment on or criticize
6 Mr. Moul's direct testimony by stating that he should
7 have included additional companies that were, for
8 example, water utilities, correct?

9 A That's correct.

10 Q So then I'd like to turn to your -- your
11 rebuttal testimony -- strike -- I'm sorry --
12 Mr. Moul's rebuttal testimony. And I'm looking at
13 Page 10 of his testimony -- his rebuttal testimony.

14 So if you'd let me know when you're
15 ready, I'll ask my question.

16 A All right.

17 Q So if you look at Lines 195 through 205 of
18 Mr. Moul's rebuttal testimony, you'll -- am I correct
19 that he acknowledges what you state in your direct,
20 that you, quote -- that you had, quote, adopted the
21 same group of gas utilities that Companies Witness
22 Moul used in his estimate of the return of uncommon

1 equity for North Shore and Peoples Gas?

2 A Yes.

3 Q Okay. And then that you went on to -- then
4 he states you went on to state that he believed the
5 proxy group provides a reasonable proxy for the
6 Utilities' operating risk.

7 Was that a fair summary by Mr. Moul of
8 what you stated in your direct?

9 A Yes.

10 Q And then Mr. Moul goes on to state that, As
11 I demonstrated in any direct testimony, the Utilities
12 actually have greater investment risk as compared to
13 the Gas Group and, as such, the results of the model
14 of the -- models of the cost of equity obtained from
15 the Gas Group understate the requirement terms for
16 the Utilities.

17 Is there anything different from -- in
18 that statement in Mr. Moul's rebuttal testimony from
19 what Mr. Moul testified in his direct testimony?

20 A He testified in both his direct and
21 rebuttal testimony that the Utilities have a greater
22 investment risk compared to the Gas Group.

1 Q I'm done with Mr. Moul's rebuttal
2 testimony. So you can put that aside. Now I want to
3 turn to your rebuttal testimony.

4 A All righty.

5 Q I'm kind of out of order. Sorry.

6 A Are you done with his direct as well?

7 Q Yes, pending need to refer back later on,
8 but I believe I'm done with it. So you can put that
9 aside.

10 So turning to your rebuttal
11 testimony -- and I will direct my attention here to
12 Pages 33 through 36 -- an initial -- a preliminary
13 question would be, would it be fair to characterize
14 this portion of your rebuttal testimony as your
15 testimony regarding a principal component analysis
16 that you performed?

17 A Pages 33 through 36?

18 Q Yes.

19 A That's true. That's a fair
20 characterization.

21 Q So -- and now focusing -- if you turn to
22 Page 35 and focus on Lines 749 through 751, isn't it

1 true that you state, Overall, my analysis indicates
2 that Peoples Gas has slightly lower financial risk
3 and lower operating risk than the Gas Group. Thus,
4 in my judgment, the overall risk of Peoples Gas is
5 lower than that of the Gas Group.

6 My question to you -- and, first of
7 all, that's a correct statement of what's in your
8 rebuttal testimony?

9 A Yes, it is.

10 Q And my question then is, isn't that a
11 change in the position you stated in your direct
12 testimony on Page 2 where you state that you believe
13 the sample companies -- Mr. Moul's sample companies
14 provide reasonable proxies for the operating risk of
15 North Shore and Peoples Gas?

16 A Based on my review at the time of my direct
17 testimony, the statement in my direct testimony
18 was -- was an accurate reflection of my position at
19 that point. I had not yet, of course, run my
20 principal components analysis. And the principal
21 components analysis revealed the -- revealed -- well,
22 one -- well, it revealed what I state here, that

1 my -- that the Peoples Gas has a slightly lower
2 financial and operating risk than the Gas Group.

3 Q What had changed between what you testified
4 in your direct testimony and Mr. Moul's rebuttal
5 testimony that led you to believe you had to conduct
6 this principal components analysis that led to your
7 change in position?

8 A His insistence that I -- my result is wrong
9 because I did not make an adjustment to my ROE, even
10 though he didn't make an adjustment to his ROE.

11 Q Well, didn't Mr. Moul state in his direct
12 testimony that in part it was one of the reasons
13 his -- his conclusion as to the relative operating
14 risk was one of the reasons why the DCF -- his DCF
15 analysis should be excluded?

16 A Well, he gave two reasons. One was because
17 it was an outlier and one was because the risk
18 between the sample and the companies differed.

19 The latter reason would apply to all
20 three models. So I can't -- I couldn't say that he
21 was, in fact, removing that for that reason. Even
22 though he states it, he gives -- the more clear

1 reason is the outlier, because the other one, like I
2 said, with the -- if it was based on a pure risk
3 difference, he would have made an adjustment to all
4 three models, but he didn't make an explicit
5 adjustment.

6 So the natural logical conclusion is
7 that while he feels it is slightly lower in risk,
8 it's not significant enough to make an adjustment.

9 Q I appreciate your comments, but I take it
10 then the answer to my question is that he stated --
11 Mr. Moul stated in his direct that one of the reasons
12 he excluded the DCF analysis was that his conclusion
13 that the comparative risk of Peoples Gas and North
14 Shore Gas were higher than the Gas Group?

15 A He did state that amongst the two reasons.

16 Q And in your rebuttal testimony, you didn't
17 state that it was anything about the logical
18 conclusion to have drawn from the -- his statements
19 and his reasons, did you?

20 A I had no reason to.

21 Q Instead, you presented the principal
22 components analysis, correct?

1 A In my rebuttal testimony after Mr. Moul
2 insisted that I needed to make an adjustment, unlike
3 what he did.

4 Q Well, in fact, did Mr. Moul also in his
5 direct testimony state that he would --

6 MR. FEELEY: Your Honors, I'm going to object.
7 Mr. Eidukas is pointing to what Mr. Moul said in his
8 testimony. His testimony speaks for itself. If he's
9 got a question on Mr. McNally's testimony, he can ask
10 questions about his testimony; but all he's doing
11 here is telling us, Didn't Mr. Moul say this, didn't
12 Mr. Moul say that? Well, his testimony is in
13 evidence.

14 MR. EIDUKAS: Your Honor, my response would be
15 that in one of his answers, Mr. McNally gave reasons
16 why he changed positions. I'm trying to examine
17 that.

18 And very briefly, I -- the question I
19 was about to ask when I was objected to was about my
20 last question on this line of questioning.

21 JUDGE HILLIARD: Okay. Ask your last question.

22 BY MR. EIDUKAS:

1 Q I can't recall if I finished the question.

2 So I will ask the question.

3 First, I'll establish -- and you say
4 that one of the reasons why you changed positions in
5 your rebuttal from your direct was an insistence that
6 Mr. Moul stated that you make an adjustment to the
7 ROE based on his comparative risk analysis?

8 A Yes.

9 Q Okay.

10 JUDGE HILLIARD: You know, I've read the
11 testimony and I've read his response and I don't
12 think that's a fair characterization of what he said.

13 So I'm going to sustain an objection
14 to the question.

15 BY MR. EIDUKAS:

16 Q Did you -- you did not present a principal
17 component analysis in either of the Utilities' prior
18 two rate cases, did you?

19 A You're testing me. I was not on the '07
20 case, I believe. And the '09 case, I'm trying to
21 think back and I don't -- no, I'm pretty certain I
22 did not.

1 Q Okay. And my question was, did you present
2 it -- did you -- do you recall if you performed an
3 analysis in relation to the 2009 rate cases?

4 A A principal components analysis?

5 Q Yes.

6 A I don't believe I did.

7 Q Why not?

8 A Again, that was two years ago. I don't
9 remember exactly the approach I took to determining
10 the cost of the sample. And I think I used a
11 different approach to determine the cost of -- I'm
12 sorry -- for selecting the sample.

13 Q I wanted to make sure you were finished
14 with your questions -- your answer.

15 When did you start working on a
16 principal components analysis for this case?

17 A I -- boy, I guess it was -- I entered the
18 data in my rebuttal testimony. I had asked a
19 question in my direct testimony with regard to
20 information that was -- that I ultimately used in my
21 rebuttal testimony. So I guess you could call that
22 working on it, but...

1 Q Did you perform more than one, for lack of
2 a better word, "run" of a principal components
3 analysis before presenting what you did in your
4 rebuttal testimony here?

5 A I don't -- I don't recall. I don't believe
6 I did.

7 Q Do you recall that back on August 19th you
8 were served with some data requests that asked you to
9 produce some additional information about the -- your
10 principal component analysis?

11 A Yes.

12 Q And in one of the responses -- and I can
13 tender to you if you don't recall -- but one of them
14 involved the need to review information that was part
15 of a proprietary computer program or of an S&P
16 Compustat tape; is that correct?

17 A Yes.

18 Do you have that?

19 Q Oh, yeah. Sure. Absolutely.

20 A I mean, do you have them all -- or -- if
21 you're only going to ask about the one, that's fine.
22 I just -- I'm sorry. If you have that one, I

1 appreciate it.

2 Q I have a copy of all of them. I was only
3 going to tender -- I was not going to ask questions
4 about all of them --

5 A Okay.

6 Q -- but if at any time you feel the need to
7 review all of them, I can make them available to you.

8 A Okay. Just the one you're asking about.

9 MR. EIDUKAS: May I approach the witness?

10 JUDGE HILLIARD: Please.

11 MR. EIDUKAS: If I could have this marked as
12 NS/PGL Cross Exhibit No. 1.

13 MR. FEELEY: What number is this? No. 1 for
14 you guys?

15 MR. EIDUKAS: I'm told it's No. 1, NS/PGL Cross
16 Exhibit No. 1.

17 (Whereupon, NS/PGL Cross Exhibit
18 No. 1 was marked for
19 identification, as of this
20 date.)

21 BY MR. EIDUKAS:

22 Q So, Mr. McNally, I've tendered to you what

1 has been marked for identification NS/PGL Cross
2 Exhibit No. 1, which -- do you recognize what this
3 is?

4 A Yes.

5 Q Is it the -- your response to a data
6 request from the Utilities?

7 A Yes.

8 Q So looking at your response, you state that
9 the -- you refer to an SAS statistical software which
10 draws raw input values directly from S&P Utility
11 Compustat database.

12 And then you state there, Compustat --
13 S&P Utility Compustat is a proprietary electronic
14 database available to Staff only through
15 subscription.

16 Could you -- my question to you is,
17 can you clarify what is the data that you drew from
18 the S&P Utility Compustat database that was used in
19 your principal component analysis?

20 A The raw data input values requested in the
21 data request. The -- what I provided -- I provided
22 to you the ratios that I calculated; but the raw data

1 that goes into those ratios, dollar value of common
2 equity, the dollar value of debt, you know, to
3 calculate various -- you know, they're -- information
4 from the companies -- the sample companies' SCC
5 reports and the financial statements.

6 Q And so is it my understanding -- so --
7 and what you provided, am I correct, were average --
8 ratios that were average ratios for the period of
9 three years?

10 A Yes.

11 Q And I believe the years were 2008 through
12 2009 -- '10?

13 A I believe that's correct. The question was
14 asked in, I believe, 15.01, I believe the answer was
15 2008. It's also in my direct test- -- or my rebuttal
16 testimony, but I believe it was 2008 through 20- --
17 through 2010.

18 Q The data that that comes from the S&P
19 Compustat database, do you pull it out -- do you get
20 the actual individual dollar amounts for, for
21 example, as you said, common equity or does it come
22 to you in the form of a ratio from S&P Compustat?

1 A It comes from S&P Compustat. It's -- the
2 database has each company and then it's got all these
3 data points. Each one represents a different -- a
4 different item from the -- from each company's
5 financial statements.

6 The program goes to the Compustat
7 database with all the raw -- those raw dollar values
8 and et cetera and pulls all the individual raw data
9 and creates these ratios and then outputs the ratios.
10 So I don't personally go -- that's what the computer
11 program is for, to access that database and draw the
12 raw data from it.

13 Q And just so I understand the data from --
14 the -- the ratios are made at your end -- at Staff's
15 end by a computer program, not by Compustat -- S&P
16 Compustat?

17 A Yes, that's correct. A Compustat -- S&P
18 basically -- I guess we're paying for it -- is for
19 them to compile all these individual data inputs from
20 the -- the annual reports of these companies. And
21 then it sends them to us, and then we use the SAS
22 program to access that data and pick -- and, you

1 know, it grabs the ratio -- I'm sorry -- the
2 ratios? -- the raw data inputs necessary to calculate
3 these ratios.

4 Q So for each of the ratios -- and I can just
5 confirm that you list 12 ratios in your rebuttal
6 testimony that you used in your principal component
7 analysis, correct?

8 A Yes.

9 Q So for each of those 12, you would need to
10 pull for each company one data point for the
11 numerator of the ratio and one data point for the
12 denominator of the ratio for each of the three years
13 in question, correct?

14 A At least. I mean, the numerators and
15 denominators frequently have more than one data point
16 entered into them. There may be a bunch of different
17 operations and include a whole bunch of different
18 data points -- or individual numbers or -- yes.
19 Effectively answer is "yes"; but it's not just one to
20 one. It's not always this number to this number; it
21 might be this number plus this number over this
22 number.

1 Q And then -- so for each of the three years
2 for each of the companies there would be this
3 calculation and you'd result in a ratio for each of
4 the -- each company for each year for each category?

5 A Yes.

6 Q And then would you computer program take
7 each of those three -- for each company would take
8 the ratio for each category for each year and add
9 them together and divide by three to get the average
10 ratio for those three years?

11 A Let me see if I can restate that -- if I
12 know what you're saying.

13 On a company-by-company basis, it
14 gathers the three-year average for each individual
15 company, correct? Is that what you're asking?

16 Q Right. I guess what I'm trying to ask is,
17 are the ratios averaged or is the data averaged and
18 then created -- made into a ratio?

19 A The ra- -- no, I'm sorry. The data is
20 averaged over three years and then the ratio is
21 calculated.

22 I've got to think about that for a

1 second. I'm not so cert- -- I'm not certain that
2 makes a difference. I'd have to think about that for
3 a minute; but I believe each ratio is calculated for
4 each year for each company, and then for each
5 company, the three-year average is calculated.

6 Q So as I understood your data request
7 response, the data points that are used to make the
8 ratios are what is proprietary and could not be
9 produced?

10 A Yes, the data -- the information is not
11 proprietary. Here is publicly available information.
12 You can go to the library and wherever you can get
13 your SCC documents off -- you know, off the Web.
14 What's proprietary is the fact that S&P has compiled
15 all that information into one place and they charge a
16 fee for that -- for that service.

17 Q But if SAS software pulled it out and put
18 it in a -- to use in a, you know, function or to make
19 these ratios, could S- -- could the SAS software
20 produce a report that indicated those data points
21 that went into it?

22 A If I could for a moment -- are you asking

1 if -- for instance, in the output I've provided to
2 the Company, I've provided all the -- I'm sorry --
3 all the ratios that were presented in this -- in this
4 question.

5 Q Could I just stop you right -- I'm sorry.
6 I didn't mean to interrupt, but I just want to
7 clar- -- so -- but am I correct that the ratios
8 presented, that's the three-year average -- that's
9 the end result ratio, whether it's the data points
10 being averaged over three years and then made into a
11 ratio or three ratios averaged together -- added
12 together and averaged, correct?

13 A I'm sorry. Could you repeat the question?

14 Q Sure.

15 When you say you presented the ratios
16 in your out- -- from your output --

17 A Mm-hmm.

18 Q -- am I correct that those ratios are the
19 result of what SAS did to the raw data points it
20 pulled from S&P Utility Compustat?

21 A Yes.

22 Q So those are either -- and, as you've said,

1 you're not sure of whether or not S- -- SAS averages
2 three years of data and then performs a ratio or
3 creates three annual ratios and then averages them?

4 A I'm not certain. I could check my work
5 papers and determine whether it's, you know, averaged
6 and then if it's averaged down and then across or
7 across and down. And I don't think that matters
8 mathematically.

9 I'm sorry. I just went far afield. I
10 lost your question.

11 Q Yeah. I'll try not to get too bogged down
12 on this; but my question is, let's assume for the
13 moment that it was the latter and that it's three
14 annual ratios that it generates -- that it generates
15 and then it averages them together.

16 A Okay.

17 Q Couldn't the SAS software present each of
18 those three annual ratios that were used to create
19 the three-year average?

20 A Yes, it could.

21 Q And your output does not show that if that
22 is how it creates that?

1 A My output gives the three-year average. It
2 skips that step, if you would.

3 Q And then let's just go back and just
4 clarify it then.

5 If it's the other way around where it
6 averages the three years of data and then it creates
7 the ratio, we see the result of that ratio being
8 performed, but in your output, we don't see the data
9 points that went into that ratio, correct?

10 A You don't see -- no, my output does not
11 present the raw data points.

12 Q Okay.

13 A Like I said, those are available publicly,
14 but we pay a description to -- for S&P to compile
15 those data points.

16 Q But when you -- is it your position that
17 when they were pulled -- those data points were
18 pulled into the SAS software, that you couldn't have
19 printed them out, the underlying data points, and
20 provided them in a report, whether for technical
21 reasons or legal reasons?

22 A Okay. I don't -- I think -- I don't

1 know -- I think I could. I don't know. I'm not a
2 lawyer. I -- I think -- I think I could have. It
3 could have been -- a program could have been made to
4 do that, but the -- but the -- but the analysis is
5 not based on -- on the raw -- the raw data; it's
6 based on the -- the principal components analysis
7 starts with the ratios. I mean, of course, they have
8 to be calculated, but -- from the raw data; but the
9 ratios, that's where the principal components start.
10 Those are the inputs to the principal components
11 analysis.

12 Q Why did you -- could you have run the
13 principal components analysis on the average of, you
14 know, a three-year average of data points as opposed
15 to the ratios?

16 A Well, I would have had to create the
17 ratios. I mean -- no, the ratios are the inputs into
18 the principal components analysis. The data points
19 are just used to calculate the ratios.

20 Q So maybe I need -- let me just restate the
21 question. I apologize if -- asked and answered, but
22 is -- my question was, in order to perform principal

1 components analysis, do you need to have ratios as
2 your input?

3 A Yes.

4 Q And why is that?

5 A Because those are the financial, for lack
6 of a better word, factor that are being analyzed.
7 Otherwise raw data is -- I wouldn't say meaningless,
8 but it's -- it doesn't tell you much. To know that
9 one company has a billion dollars of equity, that
10 doesn't mean anything in terms of the risk of the
11 company.

12 Q And in terms of the ratios that were used,
13 you chose which ratios to use for this analysis,
14 correct?

15 A Yes.

16 Q On what basis did you choose which data to
17 compare to other data to create the ratios?

18 A It was a combination of financial and
19 operating risks.

20 Q I'm sorry. Can you repeat your answer -- I
21 apologize -- or have it read back.

22 A It represented a combination of financial

1 and operating risks.

2 Q Okay. But you could have chosen two
3 different forms of these ratios, you could've
4 compared, you know, for example -- and you can tell
5 me why you wouldn't do it -- but funds from
6 operations could have been compared to revenues.

7 I mean, you could have done that,
8 correct?

9 A I could've used different ratios, but I --
10 these ratios were -- we've -- we use these ratios,
11 and we have for quite some time, as -- because we
12 believe they make the -- the best -- they represent
13 the best mix of -- they tell the best story. They
14 best represent the operating and financial risk of
15 the company.

16 Q Have you used the principal components
17 analysis in other cases?

18 A Yes, I have.

19 Q Do you recall using it in a ComEd rate
20 case -- 2005 rate case?

21 A I've used it -- I don't recall, no. I very
22 well may have.

1 MR. EIDUKAS: May I approach the witness?

2 JUDGE HILLIARD: Sure.

3 MR. EIDUKAS: Please mark this for

4 identification NS/PGL No. 1.

5 JUDGE HILLIARD: What are you going to call

6 this?

7 MR. EIDUKAS: NS/PGL No. 1 -- 2. 2.

8 (Whereupon, NS/PGL Exhibit No. 2

9 was marked for identification,

10 as of this date.)

11 BY MR. EIDUKAS:

12 Q Mr. McNally, I've handed you what has been

13 marked for identification NS/PGL Cross Exhibit 2.

14 Can you take a look at this and please

15 tell me if you recognize what this is.

16 A It appears to be my direct testimony from

17 the Commonwealth Edison Company case, 05-0597.

18 Q Could you turn in that document to Page

19 No. 2. And I want to direct your attention to

20 Lines 37 through 40.

21 Isn't it true that there you start

22 approaching a -- well, there -- you list a set of six

1 operating and financial -- financial and operating
2 ratios, correct?

3 A Yes.

4 Q And then if you turn the page, am I correct
5 then in Lines 43 through 44, you state that you take
6 those in performing principal components analysis of
7 those ratios?

8 A Yes.

9 Q So what is the basis for the difference in
10 using six ratios in the ComEd case and using the 12
11 ratios you used in the current case?

12 A Well, I typically want to use the 12 ratios
13 because we get a bigger picture. And I can't
14 remember exactly why I narrowed it to six. It may
15 have something to do with distorted data for the
16 company for certain data points. I'm pretty certain
17 that's true in one -- boy, like I said, I don't
18 remember. I mean, this was six years ago.

19 I'm not certain why -- what my reason
20 was for reducing it to six, but I suspect it had
21 something to do with certain data points being
22 distorted by whether it would be like -- well, in

1 this case, in the Peoples case, they had to pay
2 refunds in the previous years and I'm not certain --
3 like I said, I'm not certain what the reason was, but
4 there was a reason why. I would have normally used
5 the 12, but in this case I reduced it to six.

6 Q And in looking at the ComEd testimony on
7 Page 2, Line 38, your second ratio there is
8 expenditures to net utility plan?

9 A Okay.

10 Q Could you look at your rebuttal testimony,
11 Page 33, you have a ratio number -- No. 8 you have a
12 net plant to capital expenditures.

13 Are those the reciprocal of each
14 other?

15 A Which one?

16 Q No. 8 in the current -- in your rebuttal
17 testimony in this case to No. 2 in your testimony
18 from the ComEd case.

19 A Yes.

20 Q Why did you do -- why did you flip between
21 the two cases?

22 A It makes the interpretation easier, more

1 consistent. Because when you do it this way, you
2 have to look at -- normally in these ratios -- the
3 way we have it now in the ratios, a higher number
4 represents lower risk. For instance, if your
5 financial -- if your coverage ratios are higher,
6 they're high- -- more -- the farther above average
7 they are, the better financial -- you know, the
8 lesser financial risk you have.

9 When we have it reversed, we used to
10 have to take that into consideration, that that was
11 reversing the outcome. So we had to take that into
12 account so we just reversed it so it was easier to
13 remember up -- the higher the results, the lower the
14 risk.

15 Q So you're stating the way it was done in
16 this case was an improvement --

17 A Yes.

18 Q -- to offer easier interpretability?

19 A Yes.

20 Q Looking at -- and in the present case,
21 again, you used the data to create the ratios on the
22 period 2008 through 2010.

1 So that's -- so is it -- I take it
2 then that historical data is relevant to a utility's
3 cost of capital for a future test year to be used on
4 an analysis like this?

5 A To determine relative risk. And I never
6 said anything otherwise.

7 Q Is it possible that the -- an investor's
8 perception of risk in the future could diverge from
9 the risk implied by this historical data you used in
10 the analysis?

11 A That is true.

12 Q And, in fact, you couldn't say for sure
13 that this analysis is relevant to the Utility's risk
14 as compared to the Gas Group in the year 2012, in the
15 future year, correct?

16 A Well, as I've explained in my -- I think my
17 rebuttal testimony, investors can't use future data
18 that doesn't exist. So they have to start somewhere
19 and so they'll start with historical data.

20 This -- and to get the relative risk
21 level going forward -- now, things can change between
22 then -- now and then, but that's always the case.

1 Q Have you performed any comparisons of risk
2 between the Utilities and the Gas Group based on
3 Staff's proposed revenue requirement for the
4 Utilities?

5 A I have not.

6 Q Would the results of your principal
7 component analysis be different if it relied on
8 forecasted data rather than the historical?

9 A Again, I don't know that there is such
10 forecasted data available. I mean -- and if -- and
11 to the extent there is, I'm sure it's wildly
12 unreliable. I mean, you're guessing -- you know,
13 taking a shot in the dark as to what revenues are
14 going to be. It's three years from now. So it could
15 change, but I don't know how valuable that
16 information would be.

17 Q Did you employ a principal component
18 analysis in reaching your conclusion in your direct
19 testimony that the Gas Group provided a reasonable
20 proxy for determining the ROE of the Utilities in
21 this case?

22 A Did I perform a principal components

1 analysis during the time of my direct testimony not
2 presented.

3 Is that what you're getting at?

4 Q Correct.

5 A No.

6 Q For the data you used, 2008 through 2010
7 data, did you determine whether or not the data was a
8 calendar year basis, a fiscal year basis or a
9 combination of both?

10 A The raw data in the -- in the ratios?

11 Q Yes.

12 A I believe it was an end-of-year data.
13 Certain dat- -- well, I shouldn't say that. As I
14 recall, the equity ratio was a four-quarter average.
15 I think all the rest of the data was end-of-year.

16 Q If it was a mixture, would it have impacted
17 the analysis?

18 A Possibly.

19 Q Why did you only use three years of data as
20 opposed to a longer period such as five years?

21 A I think I explained that.

22 Okay. For the same reason I --

1 consistent with my criticism of Mr. Moul's analysis
2 back on Page 30 of my rebuttal testimony where I
3 state that Mr. -- much of Mr. Moul's assessment is
4 based on distorted data. This is because in March
5 2006, the Commission the companies to pay over 300
6 million in refunds to customers for giving us bad
7 debt and other costs related to in improper gas
8 charge or reconciliations. The vast majority of
9 these amounts were paid in 2006 and 2007.

10 The refund distorted the Company's
11 reported earnings, rendering any related ratios
12 worthless. Mr. Moul's analysis is based on data from
13 2005 to 2009.

14 So given the 2006 and 2007 data was
15 distorted, I excluded that data and I just used 2008
16 through 2010.

17 Q Isn't it correct that you could have
18 adjusted the data of -- for the Utilities to exclude
19 those adjustments -- those distortions?

20 A Well, I'm not certain I could have made all
21 the adjustments. I could have tempted to, certainly;
22 but I'm not certain I could capture all of the

1 effects.

2 Q Did you look -- did you look into or
3 inquire into attempting to do so?

4 A No, that was -- like I said, that was one
5 of two ways it could have gone, I guess. You could
6 have tried to make an adjustment for this data or
7 just not used the data. Of course, that would have
8 been much more -- much more difficult. And, like I
9 said, I don't know if I could've properly captured
10 all that -- captured all the effects of what happened
11 with those refunds.

12 Q Mr. McNally, how did you learn to perform a
13 principal components analysis?

14 A Through my -- well, I guess you'd call it
15 on-the-job training, if you will. I mean, I have had
16 had basic statistics in school. And so I had a basic
17 understanding of statistics. And through my
18 experience and routine training and development, we
19 go through these things. And I basically --
20 during -- for over the last twelve years, I've
21 performed this several times.

22 Q Do you recall -- when was it that you took

1 the basic statistics? Was that in undergraduate or
2 graduate school?

3 A I had, I think, two classes in undergrad
4 and at least another class in grad school.

5 Q Have you ever had a -- well, first of all,
6 am I correct in characterizing the type of statistics
7 that encompass a principal component analysis as
8 what's known as multivariate statistical analysis?

9 A I believe it could be classified as such.

10 Q Have you ever taken -- and do you know if
11 there are courses exclusively designed to teach that
12 type of statistical analysis?

13 A I assume there are.

14 Q Have you ever taken one?

15 A I'm not going to -- not in a formal
16 educational setting; but, essentially, I have through
17 my job.

18 Q Do you -- am I correct that the principal
19 component analysis is based on what's known as a
20 matrix or linear algebra?

21 A Yes.

22 Q And do you -- and is that a type of math

1 where you take matrixes of numbers and you add and
2 subtract them or multiply them?

3 A Yes.

4 Q Are you -- do you know how to perform the
5 underlying matrix algorithm that goes into a
6 principal components analysis?

7 A If I had to do it from scratch, I suppose I
8 could get a book and do it all with my math; but
9 that's the purpose of having this SAS program. It's
10 kind of like having the standard deviation function
11 in your -- in Excel. You could do it by hand, but
12 the computer -- it's already programmed in to put in
13 the -- you put in the inputs and it provides the
14 analysis. It does run the numbers for you. It's --
15 it's basically a tool used to make the process
16 easier.

17 Q So correct me if I'm wrong, but am I
18 correct in kind of saying that while you are not --
19 that you are a statistician, but that you are
20 familiar from your experience in using this SAS
21 computer program to compute or run a principal
22 components analysis?

1 A Yes.

2 Q So then is it fair to say that in
3 performing a principal components analysis, you are
4 relying upon the SAS software?

5 A Just as if you typed in 345 times 792 on a
6 calculator, you might check -- you might double-check
7 your entries to make sure your entries are right --
8 and that, I did -- but, yes, you are relying on the
9 calculator to spit out the correct answer. And in
10 this case, the same.

11 Q Well, actually -- and I think -- wouldn't
12 you agree, it's a little bit different than punching
13 numbers into an addition problem on a calculator
14 because don't you have to make certain decisions as
15 to what goes into a principal components analysis?

16 A Yes. Yes. The ratios were chosen, but
17 once the -- the statistical side of it is performed
18 by the program.

19 Q Okay. Have you read any -- are you aware
20 if there's any manuals on running principal
21 components analysis that are published by SAS?

22 A I believe we have one. I think -- I

1 believe it's published by SAS. I'm not certain, but
2 we do have a text on principal components analysis.

3 Q An SAS kind of user's manual or guide?

4 A Yes, basically.

5 Q Are you aware that SAS actually publishes a
6 specific guide on performing principal -- factor
7 analyses like a principal components analysis?

8 A Well, like I said, I'm not -- I've looked
9 at a -- a -- manuals, a sort of -- a textbook. I
10 think it's published by SAS, but I'm not sure.

11 JUDGE HILLIARD: What does SAS mean, by the
12 way?

13 THE WITNESS: It's like Statistical Analytical
14 System or something like that. It's a -- yeah, it's
15 a company essentially.

16 JUDGE HILLIARD: All right.

17 MR. EIDUKAS: If you look them up, they present
18 themselves as SAS or SAS Publishing or...

19 BY MR. EIDUKAS:

20 Q Would you agree -- would it be your opinion
21 then that if -- in terms of running a principal
22 components analysis or using the SAS program, that --

1 would you rely upon any directions or guidance that
2 SAS would provide in terms of how to use their
3 program to run this analysis?

4 A They put forth -- well, again, referring to
5 the book, I'm -- that I reviewed, they do put forth
6 guidelines, yes.

7 Q Okay. And don't you think it would be
8 important to have looked at what those guidelines are
9 before using SAS to perform a principal components
10 analysis?

11 A Yes, I agree.

12 MR. EIDUKAS: Your Honor, I'd like to approach
13 the witness with the two exhibits that I will
14 refer -- I will mark for identification, but I'm not
15 sure I'm going to admit them into evidence.

16 JUDGE HILLIARD: Okay.

17 MR. EIDUKAS: Please mark this for
18 identification as NS/PGL Cross Exhibit No. 3.

19 (Whereupon, NS/PGL Exhibit
20 Nos. 3 and 4 were marked for
21 identification, as of this
22 date.)

1 BY MR. EIDUKAS:

2 Q Mr. McNally, I've handed you two documents
3 marked for identification. Let's talk about the
4 first one first, which is NS/PGL Cross Exhibit No. 3,
5 which is a document titled A Step-By-Step Approach to
6 Using SAS for Factor Analysis and Structural Equation
7 Modeling.

8 Do you see that?

9 A Yes.

10 Q Have you ever seen a document like this
11 before?

12 A I believe this is the book that Staff has.

13 Q Okay. And you notice it's got the SAS
14 symbol on the bottom of the front cover?

15 A Yes.

16 Q And it was -- if you turn on the inside,
17 it's got a copy on the masthead -- and I'm not sure
18 what it's called in publishing terms -- the second
19 page is showing that it's a document that's been
20 published by the SAS Institute, correct?

21 A Yes.

22 Q Okay. And I'll report to you that I've

1 included -- the book itself is about 600 or so
2 pages -- that I've presented to you a copy of both
3 the table of contents and Chapter 1, which is found
4 on Page 1 of the document -- well, the page marked
5 Page 1 about three pages in titled --

6 JUDGE HILLIARD: Just a sample to get us
7 interested?

8 Never mind.

9 MR. EIDUKAS: A little -- no, I'm just trying
10 to set it up a little bit.

11 BY MR. EIDUKAS:

12 Q -- is a chapter titled Principal Components
13 Analysis, correct, on Page 1?

14 A Page 1, yes.

15 Q And do you see -- have you reviewed this
16 section of the book that you believe that Staff has?

17 A Yes.

18 Q I'm going to be referring to this document;
19 but for the moment, you can put it aside.

20 A All right.

21 Q And I just want you to look briefly at the
22 second -- the other document that's been marked for

1 identification as NS/PGL Cross Exhibit No. 4, which
2 is a document labeled SAS, slash, Stat 9.3 User's
3 Guide.

4 Mr. McNally, have you ever seen -- and
5 I'll purport to you it's a portion of the user's
6 guide on -- from SAS's Web site that itself is almost
7 9,000 pages long, but I have -- what I've put here is
8 a copy of the chapter titled The Factor Procedure.

9 So with that being said, Mr. McNally,
10 have you ever reviewed this document or a portion of
11 this document?

12 A I don't believe I've ever seen this
13 document before.

14 Q Are you aware that SAS has their user
15 guides available on their Web site?

16 A I'm not sure that I know that.

17 Q And you can put this document aside. I may
18 refer back to it as well, but...

19 MR. FEELEY: Can I interrupt for a second?

20 Do you know how much more cross you
21 have, Mr. Eidukas?

22 MR. EIDUKAS: I would say it's probably maybe

1 as long as an hour. I'll try and streamline -- I
2 will try to streamline it as much as possible, but --

3 MR. FEELEY: I'm just trying to determine if he
4 needs to take a break.

5 MR. EIDUKAS: We can take a break at this
6 point. I'm at a good --

7 JUDGE HILLIARD: Do you want to take a break?

8 MR. FEELEY: Yeah, we need a break.

9 MR. EIDUKAS: I'll try and use that to
10 streamline, your Honors.

11 (Whereupon, a recess was taken.)

12 (Change of reporter.)

13 Q You say you use the SAS program to perform
14 the Principal Component Analysis, did you have to
15 write out directions to that program to tell it how
16 to run the Principle Component Analysis?

17 A The program we have was created by Staff
18 members or a Staff member, but the principle
19 components is a function, the primary principal
20 component analysis is a function, is a SAS function,
21 a pre-program, if you will.

22 Q So the Staff member you referred to would

1 have had to take the SAS function -- I think it's
2 called the "factor function" and put into a program
3 to run the analysis along the parameters that you did
4 in this case, correct?

5 A Yes, the program first takes what variables
6 you're looking at, it sends SAS out into the copy
7 STAT and grabs those inputs, copies the variables,
8 then you have -- of course, a factor procedure that
9 runs the Principal Component Analysis, then of course
10 we had a program to provide the output.

11 Q Now, the data points that came from S&P, we
12 established earlier, are while the S&P compilations
13 are prepared, those are the public -- the data
14 principals themselves are public, correct?

15 A Yes.

16 Q So if the utilities or anyone wanted to
17 take that publicly available data and recreate the
18 analysis that you did in this case, isn't it true
19 that they would need to have that program that was
20 written by a Staff member to put those -- input those
21 data points into and run?

22 A You could create your own program.

1 Q Wouldn't the person wanting to recreate it
2 need to know what directions were given to the SAS
3 functions to recreate that?

4 A Well, like I said, the first portion of the
5 program was designed to calculate the variables,
6 those could be created -- again, you could -- there's
7 -- those are -- lost my train of thought.

8 At any rate, a program could be
9 written that -- and maybe we will use SAS in
10 particular, I assume there are other statistical
11 software packages out there they might use, but we
12 have SAS, and we've programed our SAS to create -- I
13 mean, you could recreate this with the raw data
14 available.

15 Q Is the program written by Staff in SAS to
16 perform this, is that proprietary such that it
17 couldn't be produced if requested?

18 A I don't imagine SAS has a copy of the
19 program, no.

20 Q I'm sorry?

21 A I'm sorry. I'm not hearing quite right. My
22 ear popped. Am I clear?

1 Q Yes, could I ask you to repeat the answer.
2 I guess I didn't understand your answer. I did hear
3 it. I didn't quite understand it.

4 A Could you repeat the question please.

5 Q I was asking is there any reason why the
6 program that was written in SAS to perform this
7 analysis by Staff, doing everything it did, all its
8 parameters it did to perform this analysis, is there
9 any reason why that information could not be provided
10 to a party if it was requested?

11 JUDGE HILLIARD: "Yes," "no," or "I don't
12 know."

13 THE WITNESS: I don't know.

14 BY MR. EIDUKAS:

15 Q In your Principal Components Analysis, the
16 population where you get the data from were the 95
17 companies from the S&P, correct?

18 A The 95 companies, I had their necessary
19 data to calculate the ratios, yes.

20 Q Maybe it's inherent in that answer, but how
21 did you determine those 95 companies as the
22 population for your analysis?

1 A Their drawn from the entire Compu-stat
2 database and those are the companies that were
3 remaining after eliminating the companies that don't
4 have the data necessary.

5 MR. EIDUKAS: May I approach?

6 JUDGE HILLIARD: Yes.

7 BY MR. EIDUKAS:

8 Q Mr. McNally, do you recognize what I just
9 handed you, PGL Cross-Exhibit 5?

10 A It appears to be the output from my
11 Principal Component Analysis.

12 Q And is this output solely for Peoples Gas?

13 A Yes.

14 Q I represent I gave you the Peoples Gas
15 printout output.

16 If I were to --

17 A Yes.

18 Q If I were to ask you questions about how
19 this analysis was performed, would the answers in
20 terms of the methodology and functions performed be
21 the same for both Peoples Gas and North Shore Gas?

22 A The processes, yes.

1 Q And the methodologies?

2 A Yes.

3 Q North Shore, you will note in the top-upper

4 right-hand corner of that document there is page

5 numbers that start with Page 25, so this is part of a

6 larger document.

7 A I have 26.

8 Q 26.

9 JUDGE HILLIARD: Mine says "26" also.

10 BY MR. EIDUKAS:

11 Q That's correct. We will start with Page

12 26. Using those page numbers of this document, if

13 you turn to Page 30, starting on Page 30 and

14 proceeding through Page 31, is this a list of the 95

15 companies that was the population for your analysis.

16 A Oh, I see why you probably have 25 because

17 I'm missing a page.

18 Q Yeah, there was an inadvertent omission,

19 but I really didn't have any questions on Page 25, so

20 I'm okay with it.

21 A I'm sorry to interrupt your question.

22 What was it?

1 Q That's okay.

2 If you look at Page 30 through 31 of

3 the document --

4 A Yes.

5 Q Do those pages contain a list of the 95

6 companies you used as the population for the data you

7 used in your analysis?

8 A Oh, yeah. There is three pages. There is

9 a page in between that's not marked because it

10 carried over what was originally in the printout and

11 didn't printout quite what is on the computer.

12 Q But those three pages do contain a list of

13 the 95 companies?

14 A Yes.

15 Q I will represent to you that of those 95

16 there are ten companies that appear to be water

17 companies.

18 Would you be willing to accept that

19 representation, subject to check?

20 A Can you point to which ones.

21 Q Sure. I'm looking at Lines 39, Middlesex

22 Water Company; Line 42, American States Water

1 Company; Line 49, California Water Service GP, which
2 I imagine stands for "group."

3 Line 50, Pennichuck Corporation, to my
4 knowledge, is a water company; Line 51 is American
5 Water Works Company?

6 Turning to the third page, Line 55 is
7 Aqua America, Inc; Line 67, SJW Corp, which to my
8 knowledge is San Jose Water Corporation.

9 69 is Artesian Resources, CL, which to
10 my knowledge, is a water company.

11 Line 71, which is Connecticut Water
12 Service, Inc., and Line 76 which is York Water
13 Company.

14 A I believe those are water companies, at
15 least primarily.

16 Q Why is it appropriate to compare the
17 performance of water companies to those of a natural
18 gas distribution company?

19 A Well, first of all those don't -- well,
20 never mind. They are all within the regulated
21 utility industry.

22 Q And this is, as I understood from your

1 testimony, is the ranking, the numbering of these
2 companies, is based off of your analysis that shows
3 the companies with the largest distance of divergence
4 with the results of the factors from Peoples Gas; am
5 I stating that fairly?

6 A The lower the number the closer in risk to
7 the Peoples Gas.

8 Q The first water company listed is at Line
9 39, and the last water company is at Line 76.

10 So isn't it fair to state that the
11 water companies appear to be, at least not not group
12 most closely relate to the risk of Peoples Gas?

13 A Yeah, they're somewhere in the middle.

14 Q Could you have run this analysis without
15 including those ten water companies?

16 A Yes.

17 Q Mathematical --

18 A I would have specifically had to exclude
19 them, yes, I could have.

20 Q And is it fair to state that based on your
21 earlier testimony that you did not run another
22 version of this analysis without those water

1 companies in the analysis?

2 A That's correct.

3 Q Is it possible that running analysis
4 without those water companies in the analysis, would
5 lead to a different result than this analysis?

6 A It's possible.

7 Q I just want to point your attention to this
8 list to the first -- Line 7 5 is a company called
9 Targa Resources Partners, LP.

10 And is it correct that the "LP" stands
11 for "limited partnership"?

12 A I believe so.

13 Q If you look down the list at Lines 85, 90,
14 91, 94, 95, those are also entities identified as
15 being limited partnerships.

16 Subject to check, is that accurate?

17 A 85, 90, 91, 94, 95?

18 Q Yes.

19 A Yes.

20 Q Do you know if the limited partnerships are
21 different in financial structure than a corporation?

22 A It is my understanding, they are different.

1 Q In fact, do you know if a limited
2 partnership pay income taxes?

3 A I don't believe they do directly.

4 Q And aren't there distributions from a
5 limited partnership considered tax free return of
6 capital to investors?

7 A I don't know.

8 Q Given that there are differences in at
9 least the financial nature of a limited partnership
10 from a corporation, why is it fair to include limited
11 partnerships in an analysis that was compared with
12 the financial performance of other companies that are
13 corporations?

14 A They are still classified as utilities.

15 Q Does the financial data points that are
16 pulled from S&P Compu-stat, do those numbers, data
17 point numbers, differ in nature depending on whether
18 or not a company is a limited partnership -- I'm
19 sorry -- strike that -- a utility or non-utility
20 company?

21 A How do you mean "differ in nature"?

22 Q I will strike that question because I think

1 I asked it incorrectly of what I wanted to ask, so I
2 will withdraw that.

3 What I would like to ask you is,
4 aren't the data points -- let's start with the
5 financial ratios that are part of your analysis.

6 Isn't that financial information
7 really independent from whether or not a company is a
8 utility or non-utility, and doesn't it really go to
9 the financial performance of whatever entity you're
10 looking at?

11 MR. FEELEY: It's part of a compound question.
12 You want to break it up.

13 BY MR. EIDUKAS:

14 Q If a limited partnership has different
15 financial characteristics than a corporation,
16 wouldn't those differences possibly be reflected in a
17 financial ratio of data from those entities?

18 A Possibly.

19 Q And, again, is it possible that your
20 principal component analysis would produce a
21 different result if the six limited partnerships were
22 excluded from it?

1 A That's possible.

2 Q And if both the water companies and the
3 limited partnerships were excluded, again, you would
4 have a different possible result?

5 A But I would be starting to get a small
6 sample, so there is a balance there, that's why,
7 perhaps, why those companies end up towards the
8 bottom of the list.

9 If I start eliminating -- I could make
10 it so only the top ten companies are, because those
11 are the closest in risk to Peoples, that were in my
12 sample, but then I run the problem of not having
13 enough observations.

14 Q Is it appropriate to add individuals to the
15 population of this type of analysis just for the sake
16 of increasing your sample size?

17 A Well, like I said, there is a balance
18 there.

19 Q Have you conducted any research into what
20 the minimum sample size population size should be in
21 order for a principal component analysis to provide
22 reliable results?

1 A I believe in your exhibit here, it provides
2 a number. You could correct me, if I'm wrong. I
3 don't remember where. I'm assuming, you do.

4 Q I do.

5 Actually, before you performed the
6 analysis in this case, did you will consult either
7 this manual or another resource to determine what a
8 minimum population size needed to be in order for a
9 principal component analysis to provide reliable
10 results?

11 A I don't believe I did beforehand.

12 Did you ask -- I'm sorry. I may have
13 misspoken in the last question.

14 Could you repeat that question. Could
15 you repeat it please.

16 Q Sure.

17 When I use the term "population," do
18 you understand that to mean the number of
19 individuals, or in this case companies, from which
20 you're pulling data to perform the analysis?

21 A The 95 companies?

22 Q Yes.

1 A Okay, yes.

2 Q Just so we are speaking the same language,
3 if I say for your principal component analysis, you
4 had a population of 95, that's correct, because you
5 pulled data points for 95 different companies,
6 correct?

7 A Yes.

8 Q And the data points, the ratios, the 12
9 ratios, would it be in principal-component lingo,
10 would it be fair to call those variables?

11 A Yes.

12 Q And the point of the Principle Component
13 Analysis would be -- could you tell me in your
14 understanding what is the point of running of the
15 Principle Component Analysis?

16 A It's idea is to be able to take multiple
17 data -- "factor" is not the right word -- variables
18 and distill them into a smaller number of variables
19 that are uncorrelated with each other, so as to make
20 an assessment of those, in this case ratios, cleaner.

21 Q Is it fair to say it's because you're
22 trying to see if there is an underlying and a

1 composite variable that it would explain the variance
2 between a certain number of those variables?

3 A I think that's fair.

4 Q If you turn to in that document, which has
5 been marked for identification NS PGL Exhibit 3, the
6 step-by-step approach document.

7 A Okay.

8 Q Could you read what's at the top of
9 Page 13.

10 A "Minimally adequate cycle size"?

11 Q Correct. Could you just read that first
12 two sentences.

13 A "Principal component analysis is
14 a large sample procedure to obtain
15 reliable results the minimal number
16 of subjects providing useful data
17 for analysis should be the larger
18 of 100 subjects and five times the
19 number of variables being analyzed."

20 Q Stop there.

21 So in your situation, the number of
22 variables being analyzed was 12, correct?

1 A No, the number of variables I used were 12.
2 The subject I used were 95, correct.

3 Q So five times the number of variables in
4 the case of your analysis would be 60, correct, 5
5 times 12?

6 A Yes.

7 Q What is the larger of 60 or 100?

8 A 100, so the guidelines suggest 100 and I
9 had 95.

10 Q Right.

11 And so based on that statement, your
12 sample of 95 did not -- was not large enough to what
13 this document called "obtain reliable results,"
14 correct?

15 MR. FEELEY: Objection; I think you're
16 mischaracterizing the exhibit here.

17 These are guidelines.

18 MR. EIDUKAS: Your Honor, that's a
19 characterization of the exhibit.

20 I refer Mr. McNally to testify as to
21 what the exhibit is.

22 THE WITNESS: Again, they should be. It's says

1 "should be."

2 Again, this is a general guideline,
3 pretty close to 95 and well above the 60 and, you
4 know, we can't control the number of utility
5 companies in existence, so you have to make do with
6 what we have.

7 BY MR. EIDUKAS:

8 Q Could you go down to the third paragraph on
9 this page and read that into the record.

10 A The one beginning with "these rules"?

11 Q Yes.

12 A "These rules regarding the number
13 of subjects per variable, again,
14 constitute a lower-bound and some
15 have argued that they should apply
16 only under two optimal conditions
17 for principal component analysis:

18 "When many variables are
19 expected to load on each component,
20 and when variable communalities are high.

21 "Under less optimal conditions,
22 even larger samples may be required."

1 Q Mr. McNally, did you conduct any analysis
2 to determine whether or not those two optimal
3 conditions applied in the case of the Principal
4 Component Analysis you ran in this proceeding?

5 A Yes, I believe they both do, and they both
6 fit.

7 Q So is it your position that many variables
8 load on each component?

9 A Yes.

10 Q And that the variable communalities are
11 high?

12 A Yes.

13 Q Now, going down to the middle of this page,
14 it states -- it says:

15 "What is a communality?

16 A communality refers to the percent
17 of variables in an observed variable
18 that is accounted for by the
19 retained components or factors."

20 Do you agree with that definition?

21 A Yes.

22 Q Keep that document handy, but go to output

1 for your Principal Component Analysis, which has been
2 marked as Exhibit No. 5.

3 A All right.

4 Q Can you show me where on this document that
5 it shows that you tested for the variable
6 communalities being high?

7 A This document doesn't show what I tested,
8 but it does give you the results.

9 Given the standardization of the
10 variables, to have a standardization of one, the
11 total variance in the entire analysis totals 12
12 because there are 12 variables.

13 And of my four factors, have a
14 communality of 9.47755 over 12, which -- I'm sorry --
15 they kind of account for 79.8 percent of the variance
16 in the variables.

17 Q When you're talking about the communality
18 of that 9.4775, is that on the second page or Page 27
19 of that document?

20 A Yes.

21 Q Looking at the next two lines down where it
22 says the 12 abbreviations across the top with numbers

1 underneath, those abbreviations at the top refer to
2 your 12 variables, correct?

3 A Yes.

4 Q So the first one refers to the first
5 variable in your rebuttal testimony and so on down
6 the line, correct?

7 A Yes.

8 Q So that first variable would be the common
9 equity to capitalization ratio, correct?

10 A Yes.

11 Q And the number below that and for each of
12 these is the communality for the variable, correct?

13 A Yes.

14 Q So am I correct then that your analysis
15 produced a communality for the common equity to
16 capitalization ratio of .35638212?

17 A Yes.

18 Q And doesn't that mean then that only 35.6
19 percent of the common equity to capitalization
20 variable is explained by your analysis?

21 A Yes. And that kind of makes sense because
22 common equity ratios can vary a fair amount.

1 As you see, with the other variables,
2 all variables except that one, revenue stability,
3 which is the third from the right, are well over
4 80 -- well, 68 percent. The rest are all in the
5 80's, 90 percent.

6 So in order to optimize and maximize
7 the amount of variance explained, certain variables
8 will not be explained as much, and those that have a
9 more random pattern, of course, they're not as easily
10 explained.

11 Q As you point out, the common equity
12 variable and the revenue stability variable, you
13 would agree, could not be considered themselves
14 having very high communality in this analysis?

15 A I'm not sure where that -- how you define
16 "high communality," but I would say certainly
17 relative to the other ones, they have much lower
18 communality.

19 Q Would you be willing to accept a
20 representation that if you were to look at the
21 textbooks and articles that are referred to in the
22 SAS manual, that they typical use a .70 number as the

1 rate given point for a communality being considered
2 high?

3 MR. FEELEY: Objection, you want to point to
4 something. You're testifying.

5 MR. EIDUKAS: Well, I asked him if he would be
6 willing to accept it.

7 JUDGE HILLIARD: Do you have a document you
8 want to point him to or something, you're getting
9 really specific.

10 MR. EIDUKAS: I'll move on.

11 BY MR. EIDUKAS:

12 Q You stated that your analysis explained
13 78.98 percent of the variation in the sample,
14 correct?

15 A Yes.

16 Q Can you point to where that is shown on the
17 document.

18 A That is on page -- what is marked as
19 Page 26 in the cumulative column, the top four,
20 that's the cumulative explanatory of the top four
21 factors.

22 Q And the numbers going down, the 5 through

1 12, those are other factors that the math of your
2 analysis produced, correct?

3 A Yes.

4 Q On what basis did you decide upon only
5 using the first four principal components or factors?

6 A Well, there are a number of criterion you
7 can look at -- criteria you can look at.

8 First of all, is -- first is the
9 eigenvalue, which is the explanatory value of each
10 factor. And an eigenvalue, the whole purpose as I
11 said earlier -- one of the main purposes of this
12 analysis, is to reduce a large number of variables to
13 a small, more manageable number.

14 If you start adding variables and
15 getting less than one to one explanatory power,
16 you're really defeating the purpose, so that's one
17 method of choosing.

18 Another method is to say a minimum
19 total accumulative cumulative explanatory value of,
20 you know, perhaps -- I believe this text suggests,
21 perhaps, 70 percent, I believe.

22 In this case, it explains almost

1 80 percent.

2 You could also look at it from a
3 difference -- again, this book, I think refers to as
4 a SCREE test to check to see if there is a big gap
5 between the explanatory powers.

6 If I had this additional value or this
7 next variable, I will only get this much more
8 explanatory value out of it.

9 And based on that, there is a pretty
10 big gap between my fourth and fifth.

11 So based on all three of those, the
12 suggests that 4 the proper number to keep.

13 Q So is it your testimony that you performed
14 all three of those analyses?

15 A Yes.

16 Q At the bottom of that table, there is a
17 line that says "four factors will be retained by the
18 end factor criterion." Correct?

19 A Yes.

20 Q Isn't it true that means when you told SAS
21 what to do with the data, you told it, when you ran
22 it, to only keep four variables before you saw the

1 results?

2 A That is correct.

3 Don't get me wrong, I looked at
4 this -- of course, I can't look at this before it
5 prints it out, but that's a test of -- I wouldn't say
6 it's a guess; it's an educated guess based on our
7 past practices and past knowledge of what typically
8 does falls out from these.

9 But we do plug in the 4 and it spits
10 out the results. Then we test it, and look and say,
11 are those results reasonable. And based on the three
12 different criteria, they four did seem the four
13 factors to retain.

14 Q And you refer to a SCREE test, isn't it
15 true that that involves looking at a visual graphing
16 of the factors?

17 A It's essentially graphing of the same
18 explanatory value where the -- the first value if you
19 see -- I think in this book again -- you look at the
20 graph, the first value is very high and as you get
21 farther out, the value keeps dropping, so it's the
22 same concept, you don't need a graph to show you. You

1 can see there is a big gap between the explanatory
2 value -- if there is a big gap or not -- between the
3 explanatory values of the various factors.

4 Q Is it your opinion that a SCREE test does
5 not involve the use of a graph?

6 A You're essentially doing the same thing
7 without the graph.

8 Q Is it your testimony then that to the
9 extent you performed the SCREE test here, it was done
10 without a graph?

11 A Yes.

12 Q AND SAS provides the ability to print a
13 graph out?

14 A But you don't need it.

15 Q In your opinion, you don't need it?

16 A In my opinion, you don't need it. I think
17 mathematically, you don't.

18 Q So looking at the fifth variable or fifth
19 eigenvalue on your matrix here on Page 26, it's
20 correct that it would capture .94, which is close to
21 that eigenvalue equal to the one criteria you stated,
22 correct?

1 A That reasonably close to that one, yes.

2 Q And if you look at the proportion column,
3 that data point alone would -- or that factor alone
4 would explain nearly 8 percent additional, correct?

5 A Yes, and the next one, 6 percent; and the
6 next one 2.5 percent. Each additional variable adds
7 less and less explanatory value.

8 Q Did you run a version of this analysis
9 keeping five factors to see how it would change the
10 output of the analysis?

11 A Wow, you know, I think I ran it with 3 and
12 5 and I don't remember what the results were.

13 Q Did you produce the results of those two
14 analyses?

15 A Did I produce them?

16 Q In this case, as part of your testimony or
17 work papers.

18 A No, I don't think so. I didn't present
19 those analyses.

20 Q Can you turn to Page 23 of Cross-Exhibit 3,
21 the step-by-step guide.

22 A Okay.

1 Q You see the second full paragraph down. I
2 will read what it states. It says:
3 "There are a number of problems
4 associated with the eigenvalue-1
5 criterion, however.
6 "As was suggested in the preceding
7 paragraph, it can lead to attain to
8 the wrong number of components under
9 circumstances that are often encountered
10 in research.
11 "Example, when many variables
12 are analyzed when communalities are small.
13 "Also, the mindless application
14 of this criterion can lead to
15 attaining a certain number of
16 components when the actual difference
17 in the eigenvalue of successive
18 components is only trivial.
19 "For example, if Component 2
20 displays an eigenvalue of 1.001 and
21 Component 3 displays an eigenvalue of
22 0.999, then Component 2 will be retained,

1 but Component 3 will not.

2 "This may mislead you into
3 believing that the third component was
4 meaningless when, in fact, it accounted
5 for almost the exactly same amount of
6 variance as the second component."

7 Did you consider that concept in
8 deciding to keep out the fifth factor in your
9 analysis, which had an eigenvalue, which was
10 relatively close to 1?

11 A Yes, as I discussed earlier, there were
12 numerous factors -- several criteria used.

13 As you see in regard to the example
14 they give you the input was 1.001 versus 0.999, which
15 is all .002 different; whereas, this one, my No. 4
16 factor -- I should call it "component" is 1.46;
17 whereas, No. 5 is .094. So there is a significant
18 difference between those two.

19 And like I said, a cumulative
20 explanatory value of the first four is relative high
21 without adding the fifth.

22 Q But is it true then that using the four

1 factors of your analysis that there is over 20
2 percent of the data that is unexplained?

3 A That's correct.

4 Q In the ComEd case that we had the testimony
5 marked as, I believe it was Cross-Exhibit No. 2, you
6 can refer to it, if you need to.

7 But do you recall that in case in the
8 analysis you performed, you kept only three factors?

9 A What page?

10 Q Page 3, Line 49.

11 A I retained three components in that
12 analysis, yes.

13 Q Why the difference in the number of factors
14 between that case and this case?

15 A Given, as you pointed out earlier, the six
16 financial operating ratios, which I have been
17 reminded now that that was a result of the rate
18 freeze that was in effect at the time. That was part
19 of that explanation there, too.

20 At any rate, but given that there is
21 only six ratios -- six financial operating ratios,
22 they ended up loading differently on the various

1 components. And as you pointed out in the one text,
2 if they don't load, if you're getting loading like
3 one-to-one variable, that may suggest that you're
4 splitting out a variable that really shouldn't be
5 split out. You're creating an extra factor to get a
6 tab to claim one variable, where that probably has --
7 probably if it was rerun with only three variables,
8 it would load into the combined -- into another
9 factor. And like I said, you should be having
10 multiple ratios loading on to each component.

11 Q Turning to Page 28 of your Output -- your
12 analysis.

13 JUDGE HILLIARD: Which document?

14 MR. EIDUKAS: I'm sorry. It's Cross-Exhibit 5,
15 PCA output analysis.

16 THE WITNESS: Okay.

17 BY MR EIDUKAS:

18 Q At the top it says, "The Factor Procedure
19 Rotation Method Varimax."

20 Can you please explain what this is.

21 A The purpose of -- it's the second -- this
22 page represents the second pass through the -- in the

1 principle component analysis when it creates this
2 rotative factor pattern, and the criteria used for
3 this second pass is to maximize the loading of the
4 variables on each factor, and Varimax is the method
5 that's used.

6 Q What does "orthogonal" mean?

7 A Orthogonal has to do with right angles.

8 You commented earlier how a matrix
9 you're multiplying to create new matrix, this
10 basically is when it says "rotative factor pattern,"
11 that's how the matrix is rotated in order to maximize
12 with this Varimax function, the method to maximize
13 the loading of certain variables on the -- of each
14 variable on the components.

15 Q Is it true that "orthogonal" refers to the
16 transformation keeping the components independent of
17 each other?

18 A Yes, it's references -- "orthogonal"
19 literally means right angles. But it has to do with
20 the correlation keeping the factors uncorrelated.

21 Q Aren't there methods known as oblique,
22 which tries to correlate the factors together?

1 A I believe that's true.

2 Q Why did you choose to use a orthogonal
3 rotation as opposed to an oblique rotation?

4 A Well, according to this, "it's possible to
5 perform a Principal Component Analysis if it results
6 in correlated components, such a solution is called
7 an oblique solution."

8 I did not want correlated factors.

9 Q You refer to factor loadings, can you
10 explain what that means.

11 A It's the correlation of each ratio to the
12 factor.

13 So if you look at Page 28 of
14 Exhibit 5, factor one loads heavily with cash flow to
15 capitalization, cash flow to debt, funds flow,
16 interest coverage, for example.

17 Q Turning to Cross-Exhibit 3, which is the
18 SAS publication, please look at -- the section that
19 actually starts on Page 28, but the portion I want to
20 ask you about is on Page 29.

21 Do you agree that this section is
22 setting out a suggested approach to determine the

1 loadings for the factors after you've performed the
2 rotation?

3 A Are you referring to the ABC?

4 Q Yes.

5 A The paragraph or the sentence before it
6 begins -- the last sentence of the paragraph
7 preceding that:

8 "The following text provides
9 a structured approach for interpreting
10 this factor pattern."

11 Q So is it true then the Step A that they
12 suggest to take in determining a factor pattern is to
13 read across the row for the first variable and
14 determine all meaningful loadings, which is defined
15 here is meaningful loadings rather than .40?

16 A Yes.

17 Q Two sentences down, it states:

18 "If a given variable has a
19 meaningful loading" -- which they defined
20 as .40 or greater -- "on more than one
21 component, scratch that variable out
22 and ignore it in your interpretation."

1 Do you agree with that statement?

2 A Do I agree that it states that?

3 Q First of all, do you agree it states that?

4 A Yes.

5 Q In your opinion, is that a proper approach

6 to take to determining factor loadings of a Principal

7 Component Analysis?

8 A That is certainly one guideline.

9 Q If you use that guideline in your Principal

10 Component Analysis on Page 28, isn't it true that you

11 would -- strike that.

12 Would it lead to eliminating or

13 scratching out any of your variables?

14 I will direct your attention, for the

15 sake of time, for the available the NCFEXP variable.

16 A Yes, I see that. That does load just over

17 44, but it also loads on 80 on Factor 2.

18 Q So if this approach were applied as

19 suggested in the SAS publication, you would scratch

20 that variable out, which is the acronym for Net Cash

21 Flow to Capital Expenditures, correct?

22 A As this book referred earlier to the factor

1 function criterion, following of that rule, yes.

2 Q If we were to follow that suggested
3 approach in this case, in the case of this Principal
4 Component Analysis, would you agree with me that you
5 look for loadings of at least at .40, you scratch out
6 any variables that have two factors with loadings or
7 greater than .40, that you end up with two factors
8 that have only two variables loaded on them?

9 A Let me check. I believe that's correct.

10 Q I will direct your attention to Factors 2
11 and 3, but you're free to look at all of them if you
12 desire to confirm that.

13 A Factor 3 -- give me a minute.

14 Factor 2 loads on three variables and
15 only two on Factor 3.

16 Q And with respect to Factor 2, if you were
17 to follow their advice to "scratch out" the variable
18 that loads at greater than .40 on two different
19 factors, you would only be left with two variables
20 loading on Factor 2, correct?

21 A I'm sorry. Can you --

22 Q My statement was: If you followed the

1 procedure suggested by the SAS publication of
2 scratching out any variable from your analysis that
3 loads at greater than .40 on more than one factor,
4 such that the NCFEXP variable was scratched out from
5 the analysis, isn't it true then that Factor 2 would
6 only have two variables that loaded on it at .40 or
7 greater?

8 A I can't say that for sure, because if I
9 reran it without the crash flow expenditures variable
10 we wouldn't have change.

11 Q Does the SAS publication suggest that once
12 you scratch out the variable that loads at .40 on two
13 different factors or more that you rerun the analysis
14 without that factor -- without that variable before
15 continuing on --

16 A I'm not certain.

17 Q Okay. Isn't it true the SAS publication
18 further goes on to state that you should have at
19 least three variables loading on each factor in order
20 for your Principal Component Analysis results to be
21 considered satisfactory?

22 MR. FEELEY: Are you referencing something?

1 MR. EIDUKAS: I'm asking if he knows that.

2 THE WITNESS: I'm not certain. But I will say

3 this: A lot of this is written in terms of -- in

4 fact, this particular book is written in terms of,

5 again, behavioral sciences, and the examples they use

6 are a lot of questionnaires for psychology studies

7 where you can add a lot of variables.

8 In which case, the more variables you

9 have, the more variables that we load on each factor.

10 BY MR. EIDUKAS:

11 Q I'm sorry. I thought you said earlier that

12 you said you needed financial ratios to perform a

13 Principal Component Analysis?

14 A I --

15 Q Earlier you said that's why you needed

16 ratios, you said you needed ratios because that's

17 what you needed as an input to perform a Principal

18 Component Analysis, but now are you changing that and

19 saying that you could have different type of data

20 points other than financial ratios that go into a

21 Principal Component Analysis?

22 A A principal component analysis can be

1 performed on other -- in other areas.

2 I mean, for my purposes -- okay, for
3 my purposes, yes, I am using financial ratios because
4 I'm doing a financial analysis.

5 But they can be used in other -- this
6 statistical technique and tool can be used in other
7 pursuits.

8 Q Then I have to ask the question again is,
9 why ratios and not the raw data?

10 A Because the ratios is what goes into the
11 program.

12 Q But couldn't you have put the raw data into
13 the program?

14 A No. No, because -- I'm pretty sure -- well,
15 I'm sure I could, because like I said earlier, the
16 raw data doesn't tell you -- isn't explanatory in
17 terms of telling you the relative risks of companies.

18 How do I explain this?

19 Q Let me ask another question.

20 MR. FEELEY: I'm sorry. Let him finish.

21 Okay. Go ahead.

22 THE WITNESS: When you --

1 BY MR. EIDUKAS:

2 Q So it's your opinion that in order for the
3 analysis to be meaningful that the inputs need to be
4 -- financial inputs need to be in a ratio form rather
5 than the raw data itself? In other words, you know,
6 entering -- if you undid the ratios, as you said,
7 there is more than sometimes two numbers in the
8 numerator/denominator for your 12 factors, so if you
9 just used those individual inputs, isn't it true that
10 you could have had 24 or more variables that would
11 adjust the data?

12 A Yes, but I don't believe they would be very
13 explanatory.

14 Q Have you ever tried to run a Principal
15 Component Analysis on that type of data?

16 A Not on the raw data, no, not directly.

17 Q Going back to the loading question, I'll
18 finish that up, that we were talking about --

19 JUDGE HILLIARD: How much more of this do you
20 have?

21 MR. EIDUKAS: I'm close to being done, your
22 Honor.

1 BY MR. EIDUKAS:

2 Q Would you turn to Page 12 again of the
3 step-by-step analysis.

4 JUDGE HILLIARD: Is that Exhibit 3.

5 MR. EIDUKAS: Yes, your Honors.

6 BY MR. EIDUKAS:

7 Q There is a bolded subheading called "Number
8 items per component." And I want to direct your
9 attention to the second paragraph of that section.
10 And I will read a sentence of that to you and ask if
11 you agree with its conclusion. It states:

12 "It is highly desirable to have
13 at least three and preferably more
14 variables loading on each retained
15 component when the Principal Component
16 Analysis is complete."

17 Do you agree with that statement?

18 A This gets back to what I was saying
19 earlier, this is often used for behavioral sciences
20 where people are writing questionnaires, more of a
21 study.

22 When they can continue to write --

1 they can write more questions and the more questions
2 they write, the more they can zoom in on what it is
3 they're trying to figure out.

4 But by adding the more financial
5 ratios, they can -- you're not really gaining much
6 explanatory, much insight.

7 Q Is there anything in this document that
8 indicates that its suggested guidelines or procedures
9 apply only when you're applying Principal Component
10 Analysis to a non-financial situation?

11 A No, but like the next sentence in that
12 paragraph reads:

13 "It's generally good practice
14 to write at least five items."

15 Like I said, getting back to I'm
16 writing a questionnaire, and I'm trying to get at
17 peoples' feelings about their -- in the book, I think
18 they gave the example of feelings towards their job,
19 and they're trying to -- what is the word they use?
20 "Construct". They're trying to measure that
21 construct.

22 And you can write 100 questions, if

1 you want, but there is only so many financial
2 variables that would really tell you the story.

3 If you just keep adding variables,
4 you're not really explaining anything more.

5 Q Is it possible then the Principle Component
6 Analysis is not an appropriate tool to use in this
7 type of situation where you only have so large a
8 population and so many potential variables?

9 A I don't believe that to be true.

10 JUDGE HILLIARD: I'm sorry?

11 THE WITNESS: I don't believe that to be true.

12

13 BY MR. EIDUKAS:

14 Q And that's, you don't believe that to be
15 true despite what is the guidelines being stated and
16 suggested by the programmers of SAS themselves?

17 A Yes. It says "highly desirable."

18 I agree in a perfect world, you can
19 have more things loading, but in reality, in this
20 situation, it's doesn't tell you much more.

21 Q Well, it does say it's more than desirable,
22 doesn't it? Look at the last sentence on this page.

1 A It says "highly desirable."

2 Q Doesn't it state:

3 "The recommendation of three

4 items per scale should therefore be viewed

5 as a rock-bottom lower-bound, appropriate

6 only if practical concerns, such as total

7 questionnaire length prevents you from

8 including more items"?

9 A Yes, and in this case the total

10 questionnaire length is my 12 variables, and adding

11 more variables will not give you much more, will not

12 be much more informative.

13 Q But isn't it true then that what they're

14 stating in this book, which is that if that is the

15 case, given the situation you're faced, and you end

16 up having factors less than three, isn't it true that

17 this SAS publication is stating that the results of

18 your analysis will not be considered satisfactory?

19 A I don't believe it anywhere suggests that

20 you have to have more than 12 variables.

21 Q Well, doesn't it state here you need to

22 have at least three items loading on each factor?

1 A It says it's highly desirable.

2 Q Doesn't it say it's a rock-bottom
3 lower-bound? The last sentence of that page.

4 A "Appropriate only if practical concerns
5 prevent you from including more items."

6 Q In other words, the minimum of three is
7 only appropriate when you can't have more, but you
8 need at least three, isn't that what that means?

9 A I suppose that's one interpretation.

10 MR. EIDUKAS: I have no further questions, your
11 Honor.

12 JUDGE HILLIARD: Redirect?

13 (Whereupon, there was a change
14 of reporters.)

15 JUDGE HILLIARD: Is there any redirect?

16 MR. FEELEY: Yes.

17 DIRECT EXAMINATION

18 BY

19 MR. FEELEY:

20 Q Mr. McNally, you were asked a number of
21 questions regarding your work papers. And in
22 particular, if I could direct your attention to

1 Page 28 of what's been marked for identification as
2 NS-PGL Cross Exhibit No. 5.

3 Do you have that in front of you?

4 A Page 28?

5 Q Yes.

6 A Yes.

7 Q On that Page 28 it shows four factors;
8 correct?

9 A Yes.

10 Q And if you can identify risk by using two
11 variables, do you need a third variable?

12 A Okay. Okay. If I can identify the -- if I
13 can identify the risk being measured in each -- each
14 component, each factor, adding more variables
15 wouldn't help.

16 The purpose of -- of loading these
17 variables is to determine what each factor is
18 representing. And look at the difference between --
19 with the precision of accounting data versus social
20 science questionnaires. An, again, this is -- a lot
21 of this book is directed at -- at social sciences.
22 And when they're trying to interpret, well, how do

1 you feel about this? How do you feel about that?
2 How do you feel about that? And then they're trying
3 to measure your opinion of a certain -- a certain
4 construct as they use -- is a term they use in the
5 book.

6 It's much more difficult to define
7 what it is you're trying to measure with these
8 subjective questionnaires that in somebody's opinion
9 may change from day to day. Whereas, again, with the
10 accounting -- the precision accounting data we can
11 know -- we can look at a factor and say, This factor
12 provides us -- tells us its financial risk and this
13 one tells us he its construction risk. This one
14 tells its capital intensity. And adding other factor
15 I can go out and create another variable that's --
16 for instance, the stability ratio. It would still --
17 it would just go to loading onto factor four and just
18 add another stability ratio onto factor four. And
19 wouldn't -- like I was saying earlier, would not add
20 any value.

21 MR. FEELEY: That's all I have.

22

1 BY MR. FEELEY:

2 Q Were you done?

3 THE WITNESS: I think I said this, but the
4 purpose -- well, yes, I did. I already said it. So
5 never mind.

6 MR. FEELEY: That's all I have.

7 JUDGE HILLIARD: That's all your redirect?

8 MR. FEELEY: Yes.

9 JUDGE HILLIARD: Yes, got a recross?

10 RECROSS-EXAMINATION

11 BY

12 MR. EIDUKAS:

13 Q Can I just clarify one -- clarify did you
14 testify -- what you just testified, was that stated
15 that you could define the risk from this analysis in
16 a single factor?

17 A I would have a pretty good idea what it was
18 measuring. But, again, ideally I would have a couple
19 things to kind of point to it better. But it would
20 still -- cash flow to capitalization would likely be
21 a financial risk factor.

22 Q I'm sorry. I talked about a factor.

1 Isn't that -- what you just referred
2 to a variable?

3 A Oh, I'm sorry. I misspoke.
4 Yes, a variable.

5 Q So my question was -- I wanted to clarify
6 what I thought I heard you testify, and I just -- I
7 want to make sure I didn't mishear it.

8 Was that -- was your -- I'll ask it
9 this way: Was your previous question on redirect
10 talking about adding factors or adding variables?

11 A Adding variables, I believe.

12 MR. EIDUKAS: I have no further questions.

13 But I would at this time like to move
14 into evidence NS-PGL Cross Exhibits 1, 2, 3, 4 and 5.

15 MR. FEELEY: Can we go through those one by
16 one?

17 JUDGE HILLIARD: I didn't hear what you said.

18 MR. FEELEY: Pardon?

19 JUDGE HILLIARD: I didn't hear what you said.

20 MR. FEELEY: I'd said, could we go through
21 those one at a time?

22 JUDGE HILLIARD: One at a time. Okay.

1 Do you have objections to Exhibit 1?

2 MR. FEELEY: We have no objection to NS-PGL

3 Cross Exhibit No. 1.

4 2, it's my understanding is

5 Mr. McNally's testimony from ComEd rate case. We'd

6 ask that that cross exhibit be limited to where he

7 discusses the principal component analysis, that it

8 not be his entire testimony from that docket.

9 JUDGE HILLIARD: Do you recall what pages you

10 asked him about?

11 MR. EIDUKAS: I would be --

12 JUDGE HILLIARD: Page 2 and 3?

13 MR. EIDUKAS: Yeah, Page 2, Line 32 through

14 Page -- I would say Page 4, Line 70.

15 JUDGE HILLIARD: Is that all right?

16 MR. FEELEY: Just 1 second.

17 THE WITNESS: Can you repeat that, please.

18 MR. EIDUKAS: I stated -- your Honor, I said

19 Page 2, Line 32, the heading, Sample Selection, and

20 then through page -- the end of that section, which

21 is -- ends at Page 4, Line 70.

22 And my position would be that entire

1 section is related to the sample selection analysis
2 for which it appears Mr. McNally ran a principal
3 component analysis.

4 MR. FEELEY: Yeah, with that limitation -- now,
5 will counsel be providing just those pages and then
6 anything referenced in the brief is limited to those
7 lines; correct?

8 JUDGE HILLIARD: Can you do a -- maybe you can
9 do an electronic version with a cover page and then
10 those lines?

11 MR. EIDUKAS: Yes, I could extract or delete
12 pages from the PDF.

13 JUDGE HILLIARD: Get that done before we close
14 the proceeding.

15 MR. EIDUKAS: I'll -- just to clarify, if I
16 refer to those pages of this -- right -- strike that.

17 Yes, I understand. I'll do that.

18 JUDGE HILLIARD: Exhibit 3?

19 MR. FEELEY: No. 3 we have no objection to
20 No. 3.

21 JUDGE HILLIARD: Exhibit 4?

22 MR. FEELEY: No. 4 we object to. Mr. McNally

1 had never seen this document before.

2 JUDGE HILLIARD: Okay.

3 MR. FEELEY: There's no foundation.

4 JUDGE HILLIARD: What's your response?

5 MR. EIDUKAS: We'll leave this document in as

6 marked for identification. I will withdrew moving it

7 into evidence.

8 JUDGE HILLIARD: It's withdrawn.

9 How about No. 5?

10 MR. FEELEY: No. 5 we would just like them to

11 include Page 25, and then no objection with the

12 inclusion of that page. It's something that I

13 think --

14 JUDGE HILLIARD: Well, 25 is isn't in the

15 copy --

16 MR. FEELEY: I know. If counsel provides --

17 MR. EIDUKAS: I can submit -- your Honors, I'll

18 submit copies with that page included. I would like

19 that as well.

20 JUDGE HILLIARD: So you don't object to the

21 rest of the pages, you just want it to include

22 Page 25?

1 MR. FEELEY: Yes.

2 JUDGE HILLIARD: Okay. You don't have any
3 problem with that?

4 MR. EIDUKAS: I'll stipulate to that, your
5 Honor.

6 JUDGE HILLIARD: So you'll -- we're going to
7 admit 1; 2, the lines that have been agreed to,
8 Page 2 to 4; we're going to admit 3; and we're going
9 to admit 5 with the addition of Page 25 of the same
10 document.

11 (Whereupon, NS-PGL Cross
12 Exhibits 1, 2, 3, 5 were
13 admitted into evidence.)

14 JUDGE HILLIARD: All right?

15 MR. FEELEY: Yep.

16 JUDGE HILLIARD: And you should either do this
17 electronically or provide paper copies, three of them
18 tomorrow for the court reporter.

19 MR. EIDUKAS: I'll do both, your Honor.

20 JUDGE HILLIARD: For Exhibit 2 and Exhibit 5.

21 MR. EIDUKAS: Yes, your Honor.

22 JUDGE HILLIARD: Do you have something else you

1 want to say?

2 MR. JACKSON: Just one housekeeping detail for
3 tomorrow, Ms. Hoffman Malueg, CUB has waived -- or AG
4 has waived, City has 15 minutes but has consented to
5 taking her by phone. And we're wondering if your
6 Honors would allow her to be crossed by phone?

7 JUDGE KIMBREL: This is Friday?

8 MR. JACKSON: I believe it was tomorrow.

9 MS. LUSSON: No, she's on Friday.

10 MR. JACKSON: I'm sorry. Friday.

11 JUDGE HILLIARD: We can't -- we don't have a
12 hookup? This is to telephone-telephone?

13 MR. JACKSON: That's my understanding.

14 JUDGE HILLIARD: Well, I don't think I have a
15 problem.

16 Do you?

17 JUDGE KIMBREL: No. No.

18 MR. JACKSON: Okay. Thank you.

19 JUDGE HILLIARD: Okay. We're done for today.

20 We'll resume tomorrow at 10:00.

21

22

1 (Whereupon, the above-entitled
2 matter was continued to
3 September 1st, 2011, at
4 10:00 a.m.)
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